

THE ROLE OF CORPORATE FINANCIAL CONTROL AND GOVERNANCE  
MECHANISMS IN THE SUCCESSFUL FINANCIAL MANAGEMENT OF A  
SMALL NOT-FOR-PROFIT ORGANISATION IN AUSTRALIA

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### **Certification**

I certify that the substance of this thesis has not already been submitted for any degree and is not currently submitted for any other degree or qualification.

I certify that to the best of my knowledge any help received in preparing this thesis, and all the sources used, have been acknowledged in this thesis.



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Daisy William

## Abstract

The topic of this research is, *The role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organisations in Australia.*

This research stems from a few pressing issues in the industry that have impacted on the not-for-profit (NFP) sector. Some of these issues are the closing down of valuable services due to lack of funds, the constant survival mode that small NFP organisations are working under and the difficulty in attracting skilled directors for NFPs. Currently, there is only a limited literature in the area of best practice and a model code of conduct specifically for small NFP organisations.

The literature also revealed that small NFP organisations have limited governance instruments to protect the interests of the organisation or its membership. Small NFP organisations are also loosely monitored in Australia. They are only required to submit a summary of their financial affairs at their AGM and to the NSW Fair Trading or Australian Securities and Investment Commission. There is also little accountability in this sector in that there is a clear separation of ownership and control.

Due to the fact that there is limited governance, low monitoring and low accountability in small NFP organisations, there is a need for the development of good governance instruments in order to attain public confidence and for the long-term survival of these NFPs. During the course of the study, four research questions emerged. They are:

1. What are the significant corporate governance issues that exist in small NFP organisations in Australia?
2. Are there appropriate 'best practices' that can be included to develop a corporate governance model of best practice specifically for small NFP organisations in Australia?
3. Are small NFP organisations in Australia in a precarious state of survival and extinction?

4. Will a model code of conduct strengthen the governance of small NFP organisations in Australia?

In an effort to answer the stated research questions, quantitative and qualitative data were collected using four lines of enquiry, which are literature review, an online survey, ten in-depth interviews and a case study. A mixed-method research methodology was employed because the quantitative method opened the research to the widest possible audience before narrowing it to the scope of this particular study.

Validity and reliability were ensured by testing and re-testing results until they were dealing only with issues related to small NFP organisations in Australia. At the end of a long and rigorous process, this research concludes that small NFP organisations in Australia are in dire need of help and guidance.

This study revealed:

- problematic practices, which are comparable to criminal behavior, such as intimidation, harassment, mismanagement of funds and other corrupt practices, such as putting pressure on directors to change their vote and manipulation of corporate records.
- 100 percent of the organisations interviewed had directors that did not know how to interpret financial reports.
- 90 percent of the organisations interviewed were closing down or had been on the verge of closing down at one or more times in the life of the organisation.
- 80 percent of the organisations did not have successful director recruitment process. Some of the comments made regarding the quality of directors were:
  - i) “We had ‘rogues’ on the board.”
  - ii) “We ‘hope for the best’ when directors are elected.”
  - iii) “We went to ‘hell and back’ because of the previous board.”

- iv) “Our board was dysfunctional. There was in-fighting and aggressive behavior at board meetings.”
- 40 percent of the organisations that were closing down could have continued their operation if they had partnered with other organisations that could complement their services.
  - Transparency, declaration of conflicts of interest, confidentiality, integrity are some of the codes that the interviewees felt must be included in a code of conduct that was to be specially developed for small NFP organisations in Australia.
  - There is a need for a code of conduct for directors that clearly stipulates consequences if directors breach the code of conduct.

This scenario presents a weak and volatile sector that is in a precarious state. It needs much attention and focus. This study concludes that there is an overwhelming need for mechanisms that will strengthen and provide stability to the small NFP sector in Australia. The corporate governance mechanisms that have been specifically developed for this sector through this research are:

- A Corporate Governance Model of Best Practice for Small NFP Organisations in Australia.
- A Code of Conduct for Directors of Small NFP organisations in Australia.

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## Abbreviations and Glossary

AASB	Australian Accounting Standards Boards An Australian Government statutory agency responsible for the development and promulgation of accounting standards, including the adoption of International Financial Reporting Standards. The strategic direction of the AASB is set by the parent agency, the Financial Reporting Council.
ABS	Australian Bureau of Statistics
ACNC	Australian Charities and Not-for-profit Commission
1984 Act	<i>Associations Incorporation Act 1984</i>
2009 Act	<i>Associations Incorporation Act 2009</i>
AGM	Annual General Meeting
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
Charities	According to the <i>Charities Act 2013</i> a <i>charity</i> means an entity: <ul style="list-style-type: none"> <li>(a) that is a not-for-profit entity; and</li> <li>(b) all of the purposes of which are for charitable purposes that are for the public benefit; or purposes that are incidental or ancillary to, and in furtherance or in aid of, purposes of the entity</li> <li>(c) none of the purposes of which are disqualifying purposes</li> <li>(d) that is not an individual, a political party or a government entity</li> </ul>
CEO	Chief Executive Officer
Corporations Act	<i>Corporations Act 2001</i>
Department of Fair Trading	Former name for NSW Fair Trading
EO	Executive Officer
FBT	Fringe Benefits Tax
FP	For profit
GDP	Gross Domestic Product
GST	Goods and Services Tax
ICAC	Independent Commission Against Corruption

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IRS	Internal Revenue Service
KPI	Key Performance Indicator
MP	Member of Parliament
NCOSS	Council of Social Services of NSW
NFP	Not-for-profit
NSW	New South Wales
PSASB	Public Sector Accounting Standards Board
SONG	Small organisations non-government
SPSS	Statistical Package for the Social Sciences is a software package used for statistical analysis
YWCA	Young Womens Christian Association

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## **Chapter 1: Introduction**

### **1.1 Introduction**

As the topic of this research is, *The role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organisations in Australia*, this chapter introduces the broader context in which this research was conceived. This chapter presents the research problem and the need for this study. It also draws attention to the significance of this research and its scope.

### **1.2 Statement of the research problem**

This study is about small not-for-profit (NFP) organisations in Australia. It includes all types of small NFP organisations, be they charities or other types of NFPs. This study defines small NFP organisations according to the Australian Securities and Investment Commission (ASIC) and the Department of Fair Trading's definition which classifies a small NFP organisation as one with a revenue or consolidated revenue for the financial year of less than \$250 000 (ASIC, 2012, Department of Fair Trading, 2010). The classifications of NFP organisations will be discussed in greater detail in Chapter 2.

This study stems from a few pressing issues in the industry that have impacted on small NFP organisations. Some of these issues are the closing down of good services due to a lack of funds, the constant survival mode that small NFP organisations are working under and the difficulty in attracting skilled directors. According to the literature, small NFP organisations are in a precarious state of survival and extinction (Suhood, 2001) and, for that reason, a study of their corporate governance practices is needed. This state of affairs is not sustainable, and it harms an organisation's mission and the people it serves.

A review of the literature has highlighted that models of best practice and codes of conduct are used in for-profit (FP), public and NFP sectors to

strengthen their corporate governance practices (Addison-Hewitt Associates, 2003; Australian Charities and Not-for-profit Commission (ACNC), 2013; Boyce, Griffith, & King, 2007; Cain, 2008; Dalton & Dalton, 2006; Marx & Davis, 2012b; Organisation for Economic Co-operation and Development (OECD), 2004; Weidenfeld, 2004). There are many studies focusing on large and small companies and NFP organisations. The literature also discloses that although such controls are available for NFP organisations collectively, they are not available specifically for small NFPs. This led to an investigation of whether small NFP organisations are different from their larger counterparts and whether they need a separate set of 'best practices' and codes of conduct.

Small NFP organisations differ from large organisations of the same kind in their reporting requirements, make up and organisational structure. Due to the fact that they are different from their larger counterparts, a separate set of 'best practices' and codes of conduct are required.

For small NFP organisations to become sustainable, they need to have good corporate governance practices. The objective of implementing good governance is to ensure the growth and financial sustainability of the organisation. There is a belief that there is a connection between board effectiveness and the NFP organisation's effectiveness (Herman & Renz, 1997; Jackson & Holland, 1997). Effective internal controls and governance mechanisms also help management or the governing body of an NFP entity to meet its fiduciary responsibility.

### **1.3 Context for this research**

Since a review of the literature did not indicate specific studies for small NFP organisations, this research will first investigate the NFP sector as a whole.

There has been a global rise in interest in the NFP sector (Osborne, 2003). This could be because of the need for services, that are unable to be provided by the public and FP sectors (DiRusso, 2011). The demand for

certain services and the lack of supply may be the reason for the increased demand for the NFP sector all over the world (DiRusso, 2011). This demand has resulted in a phenomenal growth in the NFP sector in the last few decades (Hodgkinson & Weitzman, 1999; Salamon, 1994).

Growth in any field brings opportunities and challenges. Offering a wider range of services, using economies of scale and having more resources are some of the opportunities presented by growth. Some of the challenges are employing staff with higher or different skills, better management of resources and the need for good governance.

Another challenge in the NFP sector is having good corporate governance. Having good corporate governance is important because it deals with fairness, integrity and accountability in the affairs of the business of an organisation (Kamakshi, 2014). Corporate governance includes, but is not limited to, financial management, strategic direction, board management and policy decisions.

Financial governance is critical for good governance of a small NFP organisation because the consequences of failure can mean that the organisation becomes insolvent. This is because a small NFP organisation would have insufficient financial resources to continue to operate if there is an impact on its finances due to bad financial decisions. Consequently, it is important that directors develop their knowledge and skills in financial governance to strengthen the corporate governance of their organisation. Good corporate governance does not only ensure long-term sustainability of an organisation, but also ensures accountability to their stakeholders.

The NFP sector, as it is known today, was born out of 'philanthropy' (Shamima, 2005). 'Philanthropy', which is an act of charitable giving, is considered to be a selfless deed (Adrian, Phelps, & Gatte, 2013). According to Adrian et al. (2013), true charity requires that a person consider other people, or in this case other organisations before themselves in the matter of giving. Philanthropy, or the act of giving, is linked to the issue of 'trust' in the

NFP sector. Donors need to be able to trust an organisation before they are able to donate to its cause. The matter of 'trust' is explained in greater detail in the literature review chapter. After being born out of philanthropy, the NFP sector has emerged as a sector of its own, and is called the third sector in the political economy of the world (Shamima, 2005). In Australia, this third sector came into being over two hundred years ago (Great Southern Press, 2009).

In practice, much attention has been placed on corporate governance in all sectors because of a few high profile company failures. There have also been a few well-publicised NFP organisations that have failed, and this has increased the need for good corporate governance in the NFP sector. One such high profile NFP organisational failure is Hull House. Hull House was a NFP organisation that provided a range of social services to thousands of low-income Chicago residents (Addams, 1990; Lissak, 1989; Moyers, 2012; Sklar, 1985). Hull House was started by Nobel laureate Jane Addams in 1889 to help Chicago's immigrants. It provided a place for them to gather to learn, to eat, to debate and to acquire the skills necessary to settle in their new country. Hull House offered foster-care services, job training, counselling and educational programs at more than 40 sites throughout Chicago (Addams, 1990; Lissak, 1989; Moyers, 2012; Sklar, 1985).

On 27 January 2012, its 300 employees received redundancy notices. On the same day, a blogger for *Crain's Chicago Business* asked how a board that included prominent lawyers, management consultants, financial advisors and corporate executives had allowed a 120-year-old community institution to collapse under its governance (Moyers, 2012).

Hull House Board Chairman, Steven Saunders, blamed the organisation's failure on the economic climate, where there was increased demand among the needy and reduced resources in the form of donations and government support (Moyers, 2012). The organisation's Form 990, which is the United States (US) informational tax return, revealed that Hull House had serious financial problems even before the recession. Its balance sheet for 2006–07

showed that its unrestricted net assets were negative \$2.3 million. Therefore, it is apparent that Hull House had a deficit of millions of dollars before the recession struck (Moyers, 2012).

The case above shows that when a Board of Directors operates a business with precarious finances, even large NFP organisations with long-standing programs and deep roots in its community can fail. It indicates that the directors may have failed in their fiduciary responsibility, resulting in the possible failure of corporate governance. The term 'fiduciary' will be explained in greater detail in Chapter Three, as it is very closely linked to corporate governance.

The literature identifies four main causes for the public's fall in the confidence in corporate governance (Hilb, 2006). They are:

- (1) the birth of the internet
- (2) the bankruptcy of major corporations such as Enron, causing stock market collapse in the US
- (3) the lack of risk management where board members had approved strategies that were too risky
- (4) the lack of integrity shown by those who are responsible for directing and controlling corporations.

From Hilb's (2006) list, it can be argued that technologies such as the internet are just tools that people can use for the benefit or detriment of a company, and that technologies by themselves are not the cause of the decline in public trust in corporations. The other three on the list can be attributed to the failure of corporate governance, as indicated by the literature (Hilb, 2006).

#### **1.4 Purpose of the research**

According to the literature, well-functioning corporate governance could ensure that an organisation or company has a competitive advantage over other similar enterprises (Bordean & Borza, 2012; Carney, 2005). In the next

chapter, it will show that the purpose of a NFP is not to make a profit, but to provide a service to society. Although the aim of a NFP organisation is not to make a profit, it nevertheless has to stay afloat. Without good governance ensuring strong financial management, no matter how much an NFP fulfills its purpose, if the funds deplete, the organisation will have to cease its operations.

Onyx, J., Cham, et al. (2015) indicates that the Australian NFP sector has adopted the US market-based economies. They indicate that large investments into the NFP sector by the government since mid 1990s coincided with a strong ideological shift to a neoliberal economic agenda. The state that the Australian NFP scene is increasingly driven by business oriented demands.

According to La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000), finance can be a factor of growth of an organisation. Savings and efficiency are factors that improve the sustainability of an entity (La Porta et al., 2000). This view is also held by Beck, Levine and Loayza (2000), who state that financial expansion can speed up economic growth. This can be done in three ways:

- enhancing savings
- channelling savings into meaningful investments which then increases the organisation's capital funds
- enabling capital funds to flow to more productive uses, which allows for improved efficiency of resource allocation. (Beck, et al., 2000)

Chief Executive Officers (CEOs), Executive Officers (EOs) or managers alone cannot be expected to take on the full responsibility for keeping an organisation in operation. Complete fiduciary responsibility lies with the NFP organisations' Boards of Directors, which means the Board of Directors is ultimately responsible (Aguilera, 2005; Considine, O'Sullivan, & Nguyen, 2014; Forbes & Milliken, 1999; Nicholson & Kiel, 2004; Petrovic, 2008).

NFPs differ in size, scope and type of service or activities they carry out (Productivity Commission, 2010). There are giant, multinational NFPs, such as the United Nations and the Catholic Church, and small community-based organisations in remote parts of the world. Due to the differing size of these NFPs, their financial set-up also differs. The executive management of an NFP can take the form of a single EO in a small organisation or a multi-layered management team headed by a CEO in a larger organisation. In any case, there is a person or a team that is accountable for the financial management of the organisation.

In a small NFP organisation with limited financial and human resources, it may be necessary to have effective internal controls and governance mechanisms to ensure the organisation's financial sustainability. Effective internal controls and governance mechanisms also help management or the governing body of an NFP entity to safeguard the organisation's financial interest and meet its fiduciary responsibilities.

This is especially critical for an underfunded small NFP organisation that only has a manager who does multiple jobs to ensure that the organisation continues to operate and function. The internal controls within the financial systems reduce risks and allow management to channel their time into performing other management responsibilities.

It is for those reasons that this research has a dual purpose. The first purpose is to develop a corporate governance best practice model specific for small NFP organisations in Australia. The second purpose is to develop a model code of conduct for directors of small NFP organisations in Australia. Currently, there are no such models or codes specific to small NFP organisations in Australia. A review of the literature does not indicate any that are readily available as far as can be determined within the scope of this research.

This research will be carried out using four lines of enquiry. The first line of enquiry is to review best practice literature that currently exists in Australia

and overseas and to use it to create a theoretical framework. Corporate governance best practices that are currently used in worldwide NFP and FP sectors will be investigated. They will then be studied for their suitability for small NFP organisations. If they are perceived to be unsuitable, they will be discarded, and if they are deemed suitable, they will be adapted specifically for small NFP organisations. All the suitable best practice statements will be grouped together to become a literature-informed proposed corporate governance model of best practice for small NFP organisations. This model will be used in the next line of enquiry.

The second line of enquiry is quantitative research. An online survey of small NFP organisations in Australia will be carried out. A questionnaire will be developed using the literature-informed model that was developed in the first line of enquiry. The questionnaire will then be placed online for participants to answer. When data from the online research are analysed, those deemed to be significant will be used in the next stage. Those that show no significance will be discarded.

The third line of enquiry is qualitative research, composed of in-depth interviews. Only questions that are deemed significant from the online survey will be expanded and used as questions for the ten in-depth interviews. Once again, those responses that do not show significance will be discarded. Those that show significance will be used in the final line of enquiry.

The last and final line of enquiry is a case study. This, too, is qualitative research. The final data findings from the research will be analysed to produce a Proposed Corporate Governance Model of Best Practice and a model code of conduct for directors of small NFP organisations in Australia.

### **1.5 Significance of the research**

The objective of implementing corporate governance best practices is to ensure the growth and financial sustainability of an organisation. For this to happen, it is important to first develop and implement financial management

strategies that include sound controls to assist an organisation to achieve revenue targets. A comprehensive system of financial controls should be maintained in order to protect an organisation's assets and finances. Managers at all levels should be responsible for implementing sound controls and for regularly monitoring and measuring their effectiveness.

Financial governance cannot be studied in isolation. A broader study which includes corporate governance must be carried out. This will ensure that both board practices and financial practices are investigated.

Currently, there are corporate governance 'best practice' studies available for NFP organisations (Boyce, et al., 2007; Cain, 2008; Marx & Davis, 2012a). However, they do not differentiate between small and large NFPs and these studies discuss all sizes of NFP organisations collectively. To date, there has been little, if any, research focusing on small NFP organisations. This particular section of the sector operates differently and faces different challenges than large NFPs. For that reason they need a different set of 'best practices'.

### **1.6 Scope of the research**

Small NFP organisations generally sit in the heart of the communities they service and they also provide an independent voice for their clients (Suhood, 2001). As mentioned previously, these organisations are often in a precarious situation between survival and extinction (Suhood, 2001). The public and government seem to not recognise small NFP organisations as a separate category that needs attention (Suhood, 2001) and they are grouped together with large NFP organisations. Suhood (2001) goes on to say that small NFP organisations do not have a strong voice, separate lobby group or body to support their maintenance and development.

Literature on good governance for small NFP organisations is lacking. Research on small NFP organisations has largely been focused on fundraising. This is due to the fact that NFP organisations depend heavily on

donations and grants (Barber, 2002; Browning, 2005; Carter & Marx, 2007; Geever, 2004). For fundraising to be successful, it is dependent on other governance instruments (Marx & Davis, 2012a). In his study, Moyers (2012) raises a few principles of good governance, such as effective board recruitment and orientation, establishing long-term objectives, program planning and ongoing evaluation.

This study will focus only on small NFPs. Furthermore, since the regulatory frameworks of NFPs differ from country to country, this study will concentrate on small NFPs in Australia only. The principles developed may be implemented for NFPs in other countries.

### **1.7 Overview of the research**

Chapter Two provides background information on NFP organisations in Australia. Academic and industry definitions of what constitutes a 'NFP organisation' are explored, and the purpose and role of such an entity are discussed. This section will also discuss the NFP sector, providing information on its history in Australia and recent reforms within the sector. It goes on to highlight the contributions of the NFP sector to the Australian economy, demonstrating its economic significance.

The current Australian legislation that exists for the NFP sector is discussed in relation to corporate governance. The next stage of the study focuses on the formation of an NFP organisation and discusses issues such as its registration, establishment, stakeholders and tax concessions in Australia. Finally, a section is dedicated to the classification of NFP organisations in Australia. It starts by describing how NFP organisations are classified by the Commonwealth and state governments in Australia, followed by their financial reporting requirements and the separation of ownership and control. This is done by using figures to compare large and small companies and large and small NFP organisations. The purpose of the comparison is to show how loosely small NFP organisations are monitored (Department of

Fair Trading, 2010) compared to large NFP organisations and companies (ASIC, 2010c).

Chapter Three builds on the background chapter. This is the literature review chapter that focuses on corporate governance. Corporate governance definition and models are first established, then, the study discusses corporate governance in the NFP and FP sectors respectively. The purpose is to establish the gap that exists in the literature for small NFP organisations.

Chapter Four examines best practice research for small NFP organisations by considering other best practice literature. A research framework is then drawn up using current best practice models in NFP organisations and FP companies. The 'best practice' principles are discussed for their suitability for small NFP organisations. The purpose is to propose a corporate governance model of best practice for small NFP organisations. At this stage, the literature-informed 'best practice' model is not specific to the Australian context.

This leads to Chapter Five, which is the research methodology chapter. While investigating the background of NFP organisations, reviewing the literature on corporate governance and establishing the theoretical framework, four research questions emerged. In this chapter, the research methodology used to obtain the answers to the research questions will be outlined. This will include the objective, design and model of the study and the process for data collection and analysis. This fifth chapter explains the methods and measures employed to conduct the investigation into the role of corporate financial control and governance mechanisms in the successful financial management of small NFP organisation in Australia.

Chapter Six presents the quantitative research results. The quantitative research results are analysed using two methods. The analysis starts with a descriptive analysis of the online survey results and moves on to discuss the logical regression analysis after the data were analysed using SPSS 17. This

chapter concludes by disclosing the questions that showed significance in the analysis.

Chapter Seven presents the qualitative research results. It starts with an explanation of how the in-depth interviews will be carried out. It then proceeds to analyse the data collected from the ten in-depth interviews. Once the data are analysed, the chapter discusses whether the in-depth interview results validate the online survey results. The purpose is to determine the reliability of the quantitative research results from the previous chapter. This is followed by a discussion of the case study and an analysis of the case study data. A section is then dedicated to corporate governance issues raised in the case study to link it to the literature review results.

Chapter eight discusses the four lines of enquiry. It starts by discussing the purpose of this mixed-method research followed by a section on the limitations of the online survey, the in-depth interviews and the case study. This chapter also brings together all the discussions about the development of a specific code of conduct for small NFP organisations in Australia, including the data collected in the interviews and the case study. This is followed by a section outlining the purpose of a code of conduct for directors of small NFP organisations in Australia. A section is dedicated to the tools that small NFP organisations can be provided with to self-regulate. The tools are the final version of a proposed corporate governance model of best practice and code of conduct for directors.

This study concludes with Chapter Nine where the contributions to research, theory and practice will be discussed. It also goes on to explore the avenues for future research.

## Chapter 2: NFP Organisations

### 2.1 Introduction

This chapter provides background information on NFP organisations to assist in the understanding of this research. It gives industry-based information that frames the development of this research.

Literature-informed definitions for NFP organisations will first be provided, because the term lacks clarity. There is ambiguity as to what a NFP organisation is and how it operates, and investigating the definition of the NFP sector will help clarify some of the ambiguity. Due to the diversity in the sector, the scope and nature of the area under study will then be defined. The reason for this section is to provide information on the purpose and role of a NFP organisation because the NFP sector is very different from the for-profit (FP) and the public sectors.

Section 2.3 explores the history of the NFP sector in Australia. This section progresses to discuss the recent reforms including the enactment of the *Australian Charities and Not-for-profits Commission Act 2012*. The purpose of this section is to show the development of this sector in Australia thus demonstrating the important contributions of the sector to the Australian economy.

Section 2.4 presents how a NFP organisation is formed and registered. It also describes the stakeholders and management of such an organisation. A separate section on tax concessions available for NFP organisations in Australia is also included, because NFP organisations all over the world enjoy tax concessions. The goal of this section is to highlight the formation and legal structure of a NFP organisation.

Section 2.5 shows the different classifications of NFP organisations set out by the Commonwealth and state governments. This section includes a comparative study of companies, companies limited by guarantee and

incorporated associations. Companies refer to companies that are propriety limited, which are for-profit (FP) entities. Companies limited by guarantee and incorporated associations are NFP organisations.

The objective of this section is to distinguish the different types of entity, and differentiate the financial reporting requirements and the separation of ownership and control of small and large businesses, and small and large NFP organisations. A clear definition of the four structures is also established. The purpose is to show financial and management differentiation between the two sizes of businesses and NFP organisations. Their definitions, operations and contributions describe the context for this research.

Chapter two will provide a clear understanding of the NFP sector, especially because the NFP sector is an arena where much economic activity takes place (Glaeser, 2003).

## **2.2 Not-for-profit organisations**

### **2.2.1 What is a not-for-profit organisation?**

NFP organisations go by different names, such as the voluntary sector (Lyons & Passey, 2006; Morris, 2000), non business (Smith, 2001) or the third sector (Lyons & Passey, 2006; Morris, 2000; Shamima, 2005). They are also known as social economy in France (Productivity Commission, 2010; Salamon & Anheier, 1997), non-profit organisations in the United States, public benefit organisations or communal enterprises in Germany (Productivity Commission, 2010), and the voluntary and non-profit sector in Japan (Osborne, 2003).

A NFP is not a household, government or FP company (Morris, 2000; Productivity Commission, 2010). When it is referred to as the third sector, the first sector is designated to be the public sector or the government sector, and the second sector is the private sector, which is the commercial sector (Australian and New Zealand Third Sector Research Incorporated, 2011;

Lyons & Passey, 2006). In Australia, the third sector is commonly known as the NFP sector, which is the term used in this research.

There is a general feeling that the NFP sector is poorly understood by the public and government (Productivity Commission, 2010). The term 'not-for-profit' is also somewhat misleading, as it implies that the organisation does not make a profit.

Not only is the term somewhat of a misnomer, but even in NFP research there is ambiguity about what organisations are considered NFP and what characteristics they need to possess in order to be considered NFP. Some believe that a NFP organisation must have a charitable purpose (Twait's, 1998). This, however, is not always the case. In Australia, a business such as a registered club or a credit union is also registered as a NFP organisation (Defourny, 2001). These businesses can make millions of dollars in profit but do not have a charitable purpose, although they may from time to time contribute towards a charitable cause.

Due to the fact that the term 'not-for-profit' is ambiguous, it is important to first study the definition of an NFP organisation before investigating its operation or contributions. The terms 'third sector' and 'non-profit sector' are derived from an Act established in the United States called the 1969 Tax Reform Act (Productivity Commission, 2010). Economists say that the primary question one would ask about the NFP sector was whether NFP organisations distributed their profits to owners or to outsiders (Hall, 1987; Hansmann, 1981). The second sector distributes its profits to owners but the third sector retains its profits in the form of surplus (Hall, 1987; Hansmann, 1981).

Economists went on to ask if the organisations were formal, voluntary and independent (Hall, 1987; Hansmann, 1981). NFP organisations had all three of the characteristics as they have a formal governance structure, are independent from government, are autonomous in decision-making and have

voluntary involvement of their members (Green, 1985; Salamon & Anheier, 1997). The above are some of the characteristics of a NFP organisation.

Other researchers, such as Kramer (1981), claim that the main characteristic of NFP organisations is their dual function as value-guardian and service providers. This definition was discredited by Anheier (2000) because Anheier feels that some NFP organisations are value-led while others operate without a value system. Therefore, it is incorrect to describe the whole sector as being value-guardian and service providers. The references in the above two paragraphs are old but they are still relevant today because a review of literature does not disclose different views.

Tonkiss and Passey (1999) suggest that the core feature of a NFP organisation is voluntarism and trust. This, too, has been discredited by Anheier (2000), because whilst some NFP organisations are run by volunteers, others are not, for example, a NFP hospital that employs medical professionals. While some researchers ascertain that NFPs are run by volunteers and are trust oriented, others do not. This leads to inconclusive results. The issue of trust will be dealt with further in Chapter Three.

A review of the literature indicates that the majority of researchers believe a NFP organisation can make a profit, but the profits are not distributed to its members (Australian Taxation Office (ATO), 2007; Glaeser, 2003; Hansmann, 1996; Lyons & Passey, 2006; Productivity Commission, 2010; Steinberg & Gray, 1992; Twaits, 1998). Instead, profits are channelled back into the organisation as surplus and must be used to carry out the organisation's purpose or core activities (ATO, 2007).

This definition is supported by the five sources quoted below. Three of the definitions are derived from Australia and two are obtained from an international source. They identify elements of the meaning of NFP organisations. The first definition is derived from the Australian Taxation Office (ATO) because it is the Australian Government's main revenue

collector. This definition is chosen because there are many tax concessions available through this office for NFP organisations.

According to the ATO (2013, p. QC 33586), the acceptable NFP definition is

A non-profit organisation is an organisation that is not operating for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up. Any profit made by the organisation goes back into the operation of the organisation to carry out its purposes and is not distributed to any of its members.

Although the ATO's definition of a NFP organisation above clearly states that a NFP organisation does not distribute its profits to its members, it also highlights two other important characteristics of a NFP organisation. The first is that the condition of non-distribution of profits applies to the organisation not only for the duration of its life but also in the event of it winding up. The second feature is that any profit made by the organisation is to be channelled back into the operation of its business.

Although the definition provided by the ATO clearly states that a NFP organisation is not to distribute its profits in the event of the organisation winding up, according to Twaits (1998), the *Income Tax Assessment Act 1997* does not prohibit incorporated associations from distributing surplus assets to their members in the event of the organisation winding up. It appears to indicate that although surplus profits cannot be distributed to the members of a NFP organisation, surplus assets can be.

The second definition below is from the Productivity Commission. This definition is chosen because the Productivity Commission is the Australian Government's independent research and advisory body (Productivity Commission, 2012). Moreover, the Productivity commission released an important report for the NFP sector in 2010 called *Contribution of the not-for-profit sector*.

According to the Productivity Commission (2010, p. xviii):

An NFP organisation is an entity that imposes the non distribution of profits to the members of the organisation.

The Productivity Commission also supports the ATO's definition that a NFP organisation does not distribute its profits to its members. Having looked at the industry-based definitions above, academic sources from Australia and overseas are studied below to provide a more comprehensive definition.

The first academic definition is from Edward L. Glaeser, a Professor of Economics at Harvard University (Glaeser, 2003). Professor Glaeser carried out research for the National Bureau of Economic Research entitled *The governance of not-for-profit organisations*. In his paper he points out three differences between FP and NFP organisations (Glaeser, 2003) which are stated below.

According to Glaeser (2003, p.1):

Nonprofit organisations have tax privileges: Donations to them are tax deductible, and nonprofit organisations are themselves free from many tax burdens. These tax advantages are at the heart of nonprofit status, and the nonprofit sector owes its strength, in part, to tax deductibility. A second difference between nonprofits and for-profits is the non distribution constraint. Nonprofit organisations cannot disburse profits to owners or employees.

As striking as these differences between nonprofits and for-profits may be, a third difference is as important in explaining the behavior of nonprofit organisations: Nonprofits do not have owners.

Just like the ATO and the Productivity Commission, Glaeser (2003) points out that NFP organisations, have a non distribution constraint on their profits. He further raises two more differences between NFP and FP organisations.

The second difference is the issue of tax concessions. Countries all over the world provide tax concessions for NFP organisations and tax exemptions for

donors to NFP organisations (DiRusso, 2011). Since this is also the case in Australia, a separate section dedicated to tax concessions in Australia is provided later in this chapter.

The third difference raised by Glaeser is the absence of owners in the NFP sector. In the FP sector, owners take the form of sole traders, partners or shareholders. The closest one can get to owners in the NFP sector are 'members'. Unlike real owners of a business, members do not share in the organisation's profits or the running of the entity. The organisation is controlled by the Board of Directors and management. There is a separation of ownership and control. This issue will be discussed further in this paper in the context of separation of ownership and management and also in the literature review chapter in the context of agency theory.

The last two definitions for NFP are taken from Twaits (1998) and Hansmann (1980). According to Twaits (1998), NFP organisations are established for a benevolent purpose while FP companies are created with the intention of securing profits for their members. He goes on to give his definition of a NFP organisation as below:

The primary difference between the two types of organisations, however, is that those operating in the non-profit sector are typically prohibited by statute and/or their constituent documents from distributing any profits they do make to their members. (Twait's, 1998, p. 314)

According to Hansmann (1980, p. 838):

A nonprofit organisation is, in essence, an organisation that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.

Although a NFP organisation is prohibited by statute or by its constitution from distributing its profits to its members, the members may benefit in other ways, such as receiving discounts when they purchase goods and services from the organisation (Kendall & Knapp, 1997; Twait's, 1998). A NFP

organisation can distribute its profits by improving the working environment of the staff and volunteers, which can come in the form of free meals, attractive benefits and longer leave (Glaeser & Shleifer, 2001).

Allowing members such benefits is not prohibited by statute. In research conducted by Glaeser and Shleifer, they concluded that higher levels of employee benefits are available in NFP than FP firms in the form of perquisites such as better working conditions, higher wages and other benefits (Glaeser & Shleifer, 2001); the greater the cash flow or profit, the higher the chance of perquisite consumption. This is in line with the notion of agency theory in the literature review chapter.

What is evident from the industry-based definitions and the academic definitions above is that a NFP organisation is not allowed to distribute its profits to its members. There are some differences in the different definitions provided above; however, the one underlying similarity is the non-distribution of profits to its members. This characteristic is critical in differentiating a NFP organisation from a FP enterprise and this is the definition that will be employed in this research.

It can be concluded that NFPs can generate profits but profits cannot, by law, be distributed to their members. Profits must be channelled back into the organisation as surplus. NFP organisations enjoy tax concessions but do not have distinguishable owners. Some NFPs may be run by volunteers but this is not the case for all NFP organisations, especially, as mentioned above, NFP hospitals that employ medical professionals, such as doctors and nurses. NFP organisations can provide discounts to their members for goods and services purchased in the organisation and provide higher levels of benefits to their employees.

Moving on from the definition of a NFP organisation, one has to look at what the purpose of a NFP organisation is if it is not for generating profits for its owners.

### **2.2.2 The purpose and role of an NFP organisation**

The NFP sector is made up of organisations aimed at creating social value for the society as a whole and not for creating profits for stockholders (Lettieri, Borga, & Savoldelli, 2004; Lyons & Passey, 2006). They are created for a community purpose, be it altruistic or mutual benefit (Green, 1985; Productivity Commission, 2010).

NFP organisations are important providers in the health, education, culture, sport and hospitality industries (Lyons & Passey, 2006). Historically, NFP organisations were started to assist the poor and disadvantaged (Billis & Glennerster, 1998; Steane & Christie, 2001). According to Twaits (1998), NFP organisations were formed for benevolent purposes, unlike a FP company which is formed for the purpose of creating a profit for its members (Weisbrod, 1988).

NFPs come in a variety of shapes, sizes and locations, and take different approaches to production and management (Productivity Commission, 2010). They operate in a number of different market sectors that are economically active, such as sports and education, as well as in social or community 'non-economic' activities, such as civil rights and religion (Productivity Commission, 2010).

Many programs run by NFP organisations would not be carried out by the FP or government sector for a variety of reasons. These reasons could be because of a lack of profitability, high risk, or because the first and second sectors do not have the type of relationship that the third sector has with the community (Productivity Commission, 2010).

Programs delivered by the NFP sector go beyond the direct outcomes for those receiving their services. The Productivity Commission gave the example of delivering disability services that have the spill-over effect of a greater understanding and acceptance by the public, which then enhances social inclusion (Productivity Commission, 2010). By this, it means that the

NFP organisation's outcome from delivering services to the disabled results in multiple benefits, such as the service being available for the disabled, the development of greater awareness about the disabled in the public and, lastly, the disabled are being included socially into society as a result of the service.

The Australian Government has an active policy of social inclusion and ensures the economic and social participation of all Australians, irrespective of their circumstances (Productivity Commission, 2010). The government uses the NFP sector to combat social exclusions by improving the economic, social, cultural and environmental welfare of its people (Productivity Commission, 2010).

In conclusion, it can be said that the NFP sector is important to the Australian economy although on the surface it looks like the only benefit it provides is a few services to the community. The NFP sector has a deeper importance because it creates jobs, provides services that allow the government to channel funds to other necessary projects within the communities in which they operate, and provides professional development and training for its staff and volunteers.

The NFP sector is not a new establishment in Australia. It has been around for two centuries and is discussed further in the next section.

## **2.3 NFP sector in Australia**

### **2.3.1 History of the NFP sector in Australia**

NFP organisations first began in Australia about two hundred years ago and have since come into their own (Great Southern Press, 2009). The Benevolent Society was established in 1813 and is believed to be the first NFP organisation in Australia (Great Southern Press, 2009). It had actively promoted change by establishing the Sydney Leadership Program to pioneer social leadership for social change (Great Southern Press, 2009).

The Young Women's Christian Association (YWCA NSW, 2011), which began in Great Britain in 1855, was established in Sydney in 1880, making it the second oldest NFP in Australia. It was established by Lady Kinnaird and Miss Emma Roberts to create a safe place for homeless women and girls. The Sydney branch was established by Mary Jane Barker, the wife of the then Sydney Bishop Frederick Barker. There are 132 YWCAs in the world today, and it continues to value its commitment to the social, economic and political equality of women (YWCA NSW, 2011).

The Royal District Nursing Service was established in 1885 in Australia to deliver home nursing care. The nursing care now includes a wide range of general and specialist nursing services (Royal District Nursing Service, 2011).

In 1889, five Sisters of Charity came to Melbourne with the hope of setting up a hospital, and their vision was realised on 6 November 1893 when they established a small cottage hospital with about 30 beds. In the organisation's first fourteen months, they treated 2584 patients, including 441 as inpatients. Some of the NFP's key achievements are the building of the hospital's first all-purpose built wing and the establishment of the St Vincent's Clinical School (St. Vincent's, 2011).

The number and diversity of small NFP organisations in NSW grew in the late 1960s, 1970s and 1980s because of the limitations of bureaucracy (Suhood, 2001). Many movements emerged such as self-help, resident action and welfare rights organisations (Suhood, 2001). The number of NFP organisations has continued to grow in Australia and a 2010 report by the Productivity Commission disclosed that there are approximately 600 000 NFPs in Australia, excluding body corporate which manage strata titles.

Having a charitable cause, the NFP sector carved a permanent role in Australian society. The sector continued to grow and draw attention to itself, causing the Australian Government to commission a range of studies and

reports in the last two decades. This had led to significant reform, which will be discussed below.

### **2.3.2 Reforms in the NFP sector in Australia**

From time to time, reports, enquiries and studies have been commissioned to understand the NFP sector in Australia. Two of these studies are a 1995 report by the former Industry Commission on *Charitable organisations in Australia*, and a 2002 report by the Australian Bureau of Statistic (ABS) report entitled *Non-profit institution's satellite account* (Productivity Commission, 2010). The NFP sector has evolved considerably since both these reports were released.

The progress in this sector gave rise to the commissioning of a new report, which was carried out by the Productivity Commission. The Productivity Commission is the Australian Government's independent research and advisory body, which researches and gives the government advice on a range of economic, social and environmental issues affecting the welfare of Australians (Productivity Commission, 2012). With its work, the Productivity Commission helps the Australian Government make better policies for the long-term interest of the Australian community (Productivity Commission, 2012). Its independence is maintained by an Act of Parliament and its work is open to public scrutiny (Productivity Commission, 2010).

The Productivity Commission was charged with undertaking a study on the contributions of the third sector, with a focus on improving the measurement of its contributions and removing obstructions in an effort to maximise its contributions to society. This report entitled *Contribution of the not-for-profit sector*, was released in 2010 (Productivity Commission, 2010). It became a seminal study used to reform the NFP sector in Australia.

This was followed by a scoping study. As part of the scoping study, the government released a consultation paper on 21 January 2011 that accepted feedback from stakeholders until the 25 February 2011 (The Treasury,

2011). It sought stakeholder statements on the goals of national regulation, the scope of national regulation and the functions and form of a national regulator, receiving 161 submissions (The Treasury, 2011).

In an effort to carry out a comprehensive consultation process, consultation was also undertaken with state and territory officials, sector representatives, and representatives from overseas governments and non-government agencies who have been involved in the NFP reform process in their respective jurisdictions (The Treasury, 2011). A final report entitled *Scoping study for a national not-for-profit regulator*, was released in April 2011. This report concluded the Australian Government's 2010 election commitment to a scoping study for a national 'one-stop shop' regulator (The Treasury, 2011).

The Australian Government then announced significant reforms for the NFP sector in the 2011–2012 Budget, including the establishment of the Australian Charities and Not-for-profits Commission (ACNC), which would be a national one-stop regulator, a tax crackdown on the commercial operation of NFPs, and the introduction of a statutory definition of charity (ATO, 2011a). The purpose of a national regulatory system is to promote good governance, accountability and transparency for NFP entities and maintain, protect and enhance public trust and confidence in the NFP sector (*Australian Charities and Not-for-profits Commission Act 2012*).

Since the implementation of a national regulator is dependent on the cooperation of the states and territories, the report also sets out immediate and short-term options to improve regulation and reduce red tape at a federal level. This report is discussed in greater detail in the following section.

### **2.3.3 The contribution of the NFP sector to the Australian economy**

This section discusses the contributions of the NFP sector to the Australian economy as disclosed in the Productivity Commission's report released in

2010. The recommendations in the report led to reforms in the NFP sector in Australia, which is why this section is dedicated to the report.

The report also shows the importance of the third sector to the Australian economy by way of its contributions to the GDP (Productivity Commission, 2012). The report highlights weaknesses in the sector and makes recommendations that will help the sector become more efficient and more accountable.

Before the Australian state of affairs is discussed, it must be acknowledged that the NFP sector is a fast expanding sector in the world and plays a vital role in many economies (Abzug & Simonoff, 2004). The NFP sector is a sizeable part of the US economy, with \$1.4 trillion in revenue and \$2.5 trillion in assets in 2006 (DiRusso, 2011). The above figures do not take foundations into consideration. Approximately \$920.6 billion of the sector's income was derived from program services (DiRusso, 2011). In Germany, the NFP sector plays a significant role in the society; in 1995, this third sector comprised 4 percent of Germany's Gross Domestic Product (GDP) (DiRusso, 2011).

Due to the sector's broad achievements and diversity, the Productivity Commission was commissioned to assess the contribution of the NFP sector in Australia and the obstacles to its development (Productivity Commission, 2010). According to the Productivity Commission (2010), there are approximately 600 000 NFPs in Australia, excluding body corporate. About 440 000 are believed to be small unincorporated organisations and 58 779 NFPs are classified by the ABS as "having an active tax role" for employing staff or accessing tax concessions (Productivity Commission, 2010, p. xxvi). The 58 779 NFPs are considered to be "economically significant", contributing approximately \$43 billion to Australia's GDP in 2006–07 (Productivity Commission, 2010, p. xxvi).

The input of the economically active NFPs to GDP increased from 3.3 to 4.1 percent of GDP between 1999–2000 and 2006–07, reflecting a strong

average annual growth of 7.7 percent in the NFP sector over the same period (Productivity Commission, 2010). The wage equivalent value of this will be discussed later in the stakeholders section of this chapter.

The overall employment growth of NFP organisations was on an average of 5.7 percent per annum from 1999–2000 to 2006–07, indicating strong growth (Productivity Commission, 2010). The employment growth was much higher than the growth in total volunteer hours, which was only 1.6 percent per annum (Productivity Commission, 2010). Although the average number of volunteering hours fell from 1999–2000 to 2006–07, the portion of the adult population volunteering rose considerably, especially amongst younger volunteers (Productivity Commission, 2010).

The economic contribution of the NFP sector is based on the value of the financial and labour inputs used (Productivity Commission, 2010). Whilst the cost of volunteer time is only a guesstimate, this does not take into consideration the total contribution of the NFP sector to their wellbeing especially the broader community benefits (Productivity Commission, 2010). Many NFP organisations add value to the community in the way they are organised, involve the wider community, make decisions and deliver their services (Productivity Commission, 2010). However, these inclusive processes can be time-consuming and expensive (Productivity Commission, 2010).

The positive effects of a NFP organisation mentioned above also add value to the Australian economy; however, these contributions are not considered by the ABS when determining the contributions of the third sector. It is important to bear in mind the many ways that the NFP sector adds value to the Australian economy.

According to the Productivity Commission (2010), there have been growing calls for accountability, and major donors increasingly want evidence of the effectiveness of the activities, preferring NFPs that can provide robust business cases for the investments they seek. Although most NFPs concur

that significant financial contributions warrant accountability, such as audited accounts, business plans and demonstrable results, it is also felt that current requirements are not appropriate, impose compliance costs without commensurate benefits and are lacking any sense of proportion with regard to the size of the organisation or scale of the undertaking (Productivity Commission, 2010).

The Productivity Commission (2010) also found that the current regulatory framework for the sector complex, lacks coherence, short of transparency, and is costly to the NFP sector. Using current systems and reform programs, the Productivity Commission (2010) proposed an integrated approach for improvement with five main elements.

The first element is knowledge management systems that assist the understanding of the sector, government and business, as well as building an evidence base for learning about effective social intervention and public policy measures.

The second element is having clearer governance and accountability through a consolidated template that can be used for all reporting purposes was also recommended. This consolidated template could be used for Commonwealth registration and tax endorsement for NFPs (Productivity Commission, 2010).

The third element is to pave the way for an improved sector development to promote and increase support services for the sector, encourage collaboration, develop expertise in governance, business planning and evaluation, promote workforce sustainability, and enhance access to capital (Productivity Commission, 2010).

The fourth element is incentive for social improvement to develop new and better ways of tackling social and other issues. The purpose of this element is to benefit the community and not for financial returns (Productivity Commission, 2010).

The fifth and last element is to build effective partnerships to strengthen collaboration and improve engagement especially in the delivery of government funded services (Productivity Commission, 2010).

The Commission (2010) recommended the setting up of a nationwide single department for Commonwealth regulation in the form of a Registrar for Community and Charitable Purpose Organisations to improve and consolidate regulatory oversight and enhance accountability to the public. A statutory organ within the Australian Securities and Investments Commission (ASIC) could initially be established to ensure timely implementation and administrative efficiency (Productivity Commission, 2010). This new statutory body would also replace the equivalent functions in existing regulators.

Following on from the Productivity Commission's recommendations, the Parliament of Australia passed a new legislation in recognition of the unique nature and diversity of NFP organisations and the distinctive role they play in Australia. This legislation is the *Australian Charities and Not-for-profits Commission Act 2012*, which will be discussed in greater detail below.

#### **2.3.4 Australian legislation for NFP organisations**

The literature demonstrates that NFP organisations are being made more accountable in Australia through legislation (Bies, 2010; Productivity Commission, 2010). State and federal legislations show that there is a greater attempt to promote good governance, accountability and transparency for NFP organisations in Australia.

When discussing state legislation, New South Wales (NSW) will be used as an example. In NSW, the administering body for NFP organisations is NSW Fair Trading (formerly the Department of Fair Trading) and the legislation governing the sector is the *Associations Incorporation Act 2009*. The issue of NFP organisations being made to be more accountable is evident in the introduction of penalties for associations and committee members for certain offences under the *Associations Incorporation Act 2009* which replaced the

*Associations Incorporation Act 1984* (Council of Social Service of New South Wales, 2013). The penalties mentioned in the *Associations Incorporation Act 2009* above do not treat small NFP organisations more leniently or differently than large NFP organisations. The penalties apply for all NFP organisations.

A later Act, the *Associations Incorporation Regulation 2010*, differentiates associations based on size. The Act requires larger associations to be classified as Tier 1 and smaller associations as Tier 2. Tier 1 and Tier 2 associations will be discussed in greater detail in Section 2.5 when FP companies are compared with NFP organisations.

In the 1984 Act, NSW Fair Trading had to take offending associations and committee members to court, while in the 2009 Act, NSW Fair Trading is allowed to issue penalty notices for certain offences (Council of Social Service of New South Wales, 2013). This gives NSW Fair Trading more power to regulate incorporated associations. In the 2009 Act, committee members incur a penalty of up to \$6600 if they neglect to disclose any conflict of interest between their own affairs and the affairs of the association (Council of Social Service of New South Wales, 2013). Committee members who use their position or information for a dishonest purpose may incur a penalty of up to \$26 400, or a two year imprisonment (Council of Social Service of New South Wales, 2013).

The *Associations Incorporation Act 2009* and the new regulation *Associations Incorporation Regulation 2010* continue to provide NSW NFP associations with an inexpensive and simpler means of incorporation (Council of Social Service of New South Wales, 2013).

As per the federal legislation, a need for greater accountability in the NFP sector is further evident in the *Australian Charities and Not-for-profit Commission Act 2012*. This Act came into law to establish the Australian Charities and Not-for-profit Commission (ACNC) and a national regulatory framework for the NFP sector, and for other related purposes (*Australian Charities and Not-for-profits Commission Act 2012*).

The Act provides for a Commissioner who will concentrate on the third sector. The Commissioner is also expected to recognise the NFP sector's unique nature and respond to the diversity and uniqueness of the sector (*Australian Charities and Not-for-profits Commission Act 2012*). He or she will be required to work with other government agencies to administer a simplified and streamlined regulatory framework for NFP organisations (*Australian Charities and Not-for-profits Commission Act 2012*). The Commissioner plays a dual role of facilitating better public understanding of the role of the NFP sector while also ensuring transparency and accountability of the sector (*Australian Charities and Not-for-profits Commission Act 2012*).

Registration with the ACNC is mandatory for access to certain Commonwealth taxation concessions (*Australian Charities and Not-for-profits Commission Act 2012*). A variety of funding is made available to the NFP sector, which includes government grants, donations, tax concessions and other financial support (*Australian Charities and Not-for-profits Commission Act 2012*). An organisation is allowed to register as a charity or NFP organisation in the ACNC register if it meets the criteria below.

- It is a NFP entity
- It is in compliance with the governance and external conduct standards
- It has an Australian Business Number
- It has not been characterised or a judgement made that it is engaging in, or supporting, terrorist or other criminal activities.

(*Australian Charities and Not-for-profits Commission Act 2012*)

What was lacking in this legislation was the definition of a charity and an NFP organisation. The lack of a definition of a charity was overcome in 2013 in new legislation, called the *Charities Act 2013*, which was enacted to define charity and charitable purpose, and for related purposes.

According to the legislation a *charity* means an entity:

- (a) that is a not-for-profit entity; and

- (b) all of the purposes of which are for charitable purposes that are for the public benefit; or purposes that are incidental or ancillary to, and in furtherance or in aid of, purposes of the entity
  - (c) none of the purposes of which are disqualifying purposes
  - (d) that is not an individual, a political party or a government entity.
- (*Charities Act 2013*)

Although the new legislation provided a definition of a charity, it was silent on the definition of an NFP entity. With the absence of this vital definition, for the purpose of this research, the definition determined in the first section of this chapter will be adopted. Thus, “a NFP organisation can generate profits but profits cannot be distributed to its members and must be channelled back into the organisation as surplus. NFP organisations enjoy tax concessions. They do not have distinguishable owners and operate with volunteers and/or staff”.

Division 45 of the *Australian Charities and Not-for-profits Commission Act 2012* allows the set-up of minimum governance standards that entities are required to meet to enable registration of their NFP organisation on an on-going basis. The standards are set up to ensure that registered entities promote the effective and efficient use of their resources, meet community expectations about managing their affairs and the use of public money, volunteer time and donations, and minimise the risk of mismanagement and misappropriation (*Australian Charities and Not-for-profits Commission Act 2012*).

There are five governance standards for ACNC registration. The standards are that these registered entities work towards their charitable mission and be prepared to provide this information to the public, take reasonable steps to be accountable to their members and provide them an opportunity to raise concerns, must not commit a serious offence under any Australian law, must check that their responsible persons are not disqualified from managing a corporation under the *Corporations Act 2001* or disqualified from being a responsible person of a registered charity by the ACNC Commissioner, and

lastly take reasonable steps to make sure that responsible persons understand and carry out the duties set out in this standard (*Australian Charities and Not-for-profits Commission Act 2012*).

In conclusion, it is evident that the above development in the state and federal legislation shows that greater accountability and transparency is expected of all NFP organisations, irrespective of their size. This is especially evident in the introduction of a penalty in NSW of up to \$6600 if directors neglect to disclose any conflict of interest between their own affairs and the affairs of the association. Small NFP organisations will benefit greatly if they have a code of conduct for directors and a model of best practice, because currently there are no specific models for this section of the sector.

Having studied the NFP sector and its legislation in Australia, the following section will demonstrate how NFP organisations are registered, established and managed.

## **2.4 Formation**

### **2.4.1 Registration of an NFP organisation**

Over the years, with the growth of NFP organisations, the Australian Government has allowed them to take the form of one of several legal structures, but the most common ones are the three structures below:

- public company limited by guarantee (governed by the *Corporations Act 2001*)
- incorporated association (governed by state legislation)
- unincorporated association

(Australian Institute of Company Directors, 2007; Twaits, 1998)

Under a company structure, a NFP organisation is registered as a company that is limited by guarantee (Twait's, 1998). In the Corporations Act, Section 9 the company limited by guarantee is defined as one that is formed on the basis of having the potential liability of members limited to the amount that a particular member has 'guaranteed' to pay under the company's

memorandum of association (Twaits, 1998). The term 'limited by guarantee' indicates that the liability of the company's members is limited to the amount the members undertake to contribute to the property of the company should it wind down (ASIC, 2010a; Australian Institute of Company Directors, 2007; Twaits, 1998).

If, however, a company has insufficient funds to meet its liabilities, persons who were members within a year of the date on which the winding up action commenced may be required by the courts to honour their guarantees under Pt 5.6 Div 2 of the Corporations Law (Twaits, 1998). Past members are liable to debts incurred only up to the date on which they ceased to become members of the company.

To register a NFP organisation as a company, the members create a legal entity separate from its members, enabling the company to hold property and sue and be sued (ASIC, 2010a). The *Corporations Act 2001* under which companies are registered is Commonwealth legislation administered by the Australian Securities and Investments Commission (ASIC) which is a federal agency (ASIC, 2014a).

Any reference to shareholders in the Corporations Law does not apply to members of companies limited by guarantee, because such companies do not have share capital. A reference to a 'member' includes a reference to a member of a company that is a company limited by guarantee, apart from specific exceptions (Twaits, 1998).

The second way in which a NFP organisation can be registered is as an association. Associations are incorporated under state and territory associations incorporation legislation regulated by the different state authorities and are not administered by ASIC (ASIC, 2010a). In this study, NSW will be used as the example when discussing state level regulations. Members are immune from personal liability in a third party lawsuit (Twaits, 1998).

Due to the fact that all incorporated associations in all jurisdictions are granted corporate status, they inherit all the legal attributes of a corporation, such as:

- recognition as a separate legal entity with perpetual succession and a common seal
- an ability to contract
- an ability to acquire, hold and dispose of real or personal property
- an ability to sue or be sued in its own name. (Twaits, 1998)

Incorporating an association in a state or territory restricts the organisation to operating only in the state or territory in which it is registered (ASIC, 2010a).

The third legal structure for a NFP organisation in Australia is unincorporated association. The term 'unincorporated association' is usually applied in relation to a group of people who meet for a common interest and serve in a voluntary capacity to further a common interest or purpose (Twaits, 1998). Although member subscriptions are their main source of funding, they also raise funds through intermittent fundraising activities such as raffles. A committee elected by the members manage and run the organisation (Twaits, 1998). Some unincorporated associations have a constitution or a statement of objectives but others do not (Twaits, 1998). In an unincorporated association, there is no relationship between members and the association, whether contractual or otherwise. The lack of a contractual relationship between the members and the association means that members have no standing to challenge the decisions of the association's committee (Twaits, 1998).

The duties and liabilities of directors in different types of companies, whether FP companies or NFP organisations, are generally similar. There may however, be some differences between state legislation and the *Corporations Act 2001*. Whatever form of legal structure a NFP organisation may take, all actions must be carried out in good faith and in the best interests of the organisation (Australian Institute of Company Directors,

2007). For that reason, registered NFP organisations are required to be financially accountable.

Besides the above three methods of registering a NFP organisation, there are other forms of registering specific types of NFP organisations. Co-operatives and organisations established by special Acts of Parliament are some of them (Australian Institute of Company Directors, 2013). A NFP mutual is an example of a co-operative (Productivity Commission, 2010) while the Indigenous Corporations is a corporation incorporated under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* which is regulated by the Office of the Registrar and Indigenous Corporations (Productivity Commission, 2010).

Although the above legal structures are available for registering NFP organisations of all sizes, the focus of this paper is only small NFP organisations in Australia.

#### **2.4.2 Establishment of an NFP organisation**

Having explored the different legal structures available for NFP organisations to register, this section moves on to demonstrate how they can be established.

As mentioned above, in this study, NSW will be used as the example when discussing state level regulations. If a NFP organisation is to be established through a state legislation, such as in NSW, it will be governed by NSW Fair Trading and formed according to the *Associations Incorporation Act 2009* (NSW Fair Trading, 2013). Guidance is given on the NSW Fair Trading website to those interested in forming a NFP organisation registered as an incorporated association. The number of members required to register a NFP organisation through NSW Fair Trading is five or more. The group should be able to meet the costs and obligations involved in forming and running an incorporated association. Penalty notices, prosecution or cancellation of the

association's incorporation are some of the consequences of failing to meet these obligations (Fair Trading, 2013).

A statement of the association's objectives and an appropriate constitution is also a requirement for its formation. The constitution of an incorporated association forms the scope and operational structure within which the association functions. As the constitution of an incorporated association is a contract between the association and its members, they must agree to adhere to the provisions outlined in the constitution. NSW Fair Trading provides a model constitution that can be adopted by groups intending to form an association, or they may choose to write their own constitution. The association's constitution is recorded in the public register of incorporated associations, maintained by NSW Fair Trading (Fair Trading, 2013).

NSW Fair Trading requires that any constitution have sixteen mandatory parts, which are outlined on their website. The constitution must include the requirement to be a member, the register of the association's members, any entrance fees, subscriptions and other amounts to be paid by the members, and members' liability towards the debts and liabilities of the association. The constitution must also include the procedure for disciplining members, including an appeals process, the procedure for the resolution of disputes between members and between members and the association.

It must also have the establishment, functions and processes for the committee, the procedure of holding and calling a general meeting, the process for notifying members of a general meeting or motion, the quorum, procedure and requirements for conducting a general meeting, and the types of resolutions that may be voted on by a postal ballot. Other matters that have to be included are the sources of the association's income, how the association's funds are to be managed and the procedure for drawing and signing cheques on the association's behalf, who is responsible for the association's books, documents and securities, the procedures and costs associated with the inspection of books and documents by members, and

finally, what is deemed to be the association's financial year (Fair Trading, 2013).

A NFP must establish a committee to manage the association's affairs. The committee must consist of at least three members, each over 18 years of age and at least three of whom reside in Australia. Any group adopting NSW Fair Trading's model constitution must have seven members. The responsibility of the committee is to ensure that the association meets its legal and reporting obligations (Fair Trading, 2013). The committee of an incorporated association must appoint a public officer who is over 18 years of age and who resides in NSW. The public officer is an authorised signatory for the association and is the official point of contact for the association (NSW Fair Trading, 2013). The association must have an official address in NSW. This may be premises of the association, or the residential address, the place of business or employment of the public officer (Fair Trading, 2013).

The association must reserve a name by lodging a form called A1 along with the prescribed name. The association is then to apply for incorporation by lodging a second form, called an A2, which is the application for registration. This form is to be submitted along with the registration fee at any NSW Fair Trading Centre or by mail to the Registry Services (Fair Trading, 2013). The Annual General Meeting (AGM) for an Incorporated Association must be held within six months of the end of its financial year, except for the first annual general meeting which must be held within 18 months from the date of incorporation (Fair Trading, 2013). The association should also consider its own insurance requirements, including the need for public liability insurance, and take out appropriate insurance as necessary (Fair Trading, 2013).

Australia-wide, a NFP organisation can also be established under a company structure. They are registered as public companies that are limited by guarantee under the *Corporations Act 2001*). This company structure is administered through Commonwealth legislation and is administered by ASIC (ASIC, 2014a).

A company registered under the *Corporations Act 2001* is recognised Australia-wide. Under this Act, a public company must have at least three directors, one secretary, one member and maintain a register of its members (ASIC, 2014a). The NFP organisation must also have a registered office address open and accessible to the public, and the principal place of business must be located in Australia. The organisation must be internally managed by a constitution or replaceable rules, keep a record of all directors, members, meeting minutes and resolutions, appoint a registered company auditor within one month of its registration, keep proper financial records, and prepare, have audited and lodge financial statements and reports after the end of every financial year (ASIC, 2014a).

The requirement to have their financials audited does not apply to some companies that are limited by guarantee. This matter will be discussed in greater detail in the later part of this chapter. A copy of a company's financial statements and reports must be sent to its members, unless any member has a standing arrangement with the company not to receive them. Once again this does not apply to some companies that are limited by guarantee. A company limited by guarantee must also hold an AGM once every calendar year, within five months following the end of the financial year (ASIC, 2014a). It must receive and review an annual company statement, pay an annual review fee and lodge notices whenever changes to its officeholders, office addresses, constitution and name occur within specified timeframes as determined by the *Corporations Act* (ASIC, 2014a).

When a company is limited by guarantee, it may also be registered without the word 'Limited' in its name. This is allowed if it has a solely charitable purpose that is clearly stated in its constitution, disallows the company making distributions to its members and paying fees to its directors, and requires the directors to approve all other payments the company makes to directors (ASIC, 2014a).

People are an important resource for all NFP organisations. As mentioned in the section about the report released by the Productivity Commission, the

third sector relies heavily on volunteers. The section below discusses the different stakeholder groups involved in a NFP organisation.

### **2.4.3 Stakeholders of NFP organisations**

When a NFP organisation is formed, people get involved in it and are invested in the organisation in some form. This could be in the form of employment, a service they receive, time they spend in the organisation or other non-financial benefits they receive. The people who are involved in the organisation in some form are called stakeholders. These different groups of people will be discussed in greater detail in this section.

NFP organisations' stakeholder groups include the Board of Directors, executive management, staff, volunteers, funders, beneficiaries, suppliers or contractors, competitors and partners (Van Puyvelde, Caers, Du Bois, & Jegers, 2012). Van Puyvelde et al. (2012) also has an 'others' category, comprising external stakeholders such as the media, community groups and persons or groups who are affected by externalities produced by the NFP organisation. Van Puyvelde et al. (2012, p. 434) placed donors, sponsors and government agencies together as 'funders'.

Van Puyvelde et al. (2012) overlooked a very important group, which is the members. Although members play a secondary role to the Board of Directors and CEO, they are a very vital stakeholder group for any NFP organisation. Members could be defined as persons that have a membership in the NFP organisation because they believe they will receive benefits that exceed the costs of their membership (Tschirhart, 2006). Although NFPs are created for a community purpose, the direction they take is determined by how the members initially set it up (Productivity Commission, 2010).

The next stakeholder group in a NFP organisation is the Board of Directors. This group takes on legal responsibilities for corporate actions and the impact these actions might have on society (Alkhafaji, 2007). In a NFP organisation, it is the Board of Directors that is the governing body and is the

representative of the organisation to external agencies (Anheier, 2005). It is the Board of Directors that ensures the organisation's mission is fulfilled (Anheier, 2005). The Board of Directors of NFP organisations have the task of balancing needs with the best interests of the organisation. Board members may be nominated by a particular stakeholder group but it is important that they realise that once appointed, a director's duties are owed to the organisation and not to their nominators (Australian Institute of Company Directors, 2007).

If the organisation is a community group with limited resources and insufficient staff, the board may take a hands-on role in the management of the organisation (Carver, 2006). It is important that the roles and responsibilities are set out in the organisation's constitution or board charter.

In an organisation where there is a CEO, the role of the board is to govern and to leave the management of the organisation to its CEO (OECD, 2004b). Conflicts may arise if the Board of Directors cross the line and interfere in the management of the organisation and take over the day-to-day running of the business. Clear separation of power is vital for the smooth running of any organisation (OECD, 2004b).

The managers make up another stakeholder group (Van Puyvelde et al., 2012). The executive management of a NFP can take the form of a single Executive Officer (EO) in a small organisation or a CEO in a larger organisation (Suhood, 2001). Although in a larger organisation there may be a team that is responsible for the financial management of the organisation, ultimately it is the CEO who is accountable for the financial management of any organisation. In a small NFP, the EO is expected to be skilled in the management of finances, human resources, facilities and assets, which means the person is responsible for the whole management of the organisation.

The Board of Directors and executives are responsible for the strategic management of the organisation (OECD, 2004b). Strategic management is a

set of directions and actions that the executive management and Board of Directors devise to ensure the progress of an organisation. It includes industry analysis, setting strategic objectives and strategic options, implementation of strategies and evaluation and control (Wheelen & Hunger, 2008). In brief, it can be said that strategic analysis involves analysis, decisions and actions (Dess, Lumpkin, & Taylor, 2005). The purpose is to maintain competitive advantage for the organisation (Dess et al., 2005).

Managers attempt to better deal with the changing world environment by evolving through four phases of strategic management (Gluck, Kaufman, & Walleck, 1982). According to Gluck et al. (1982), phase 1 involves basic financial planning. Managers initiate planning when they propose the next year's budget.

Phase II involves forecast-based plans. Managers propose five-year plans to enhance annual budgets with a long-term plan (Gluck et al., 1982). Managers may study why some firms outperform others (Dess et al., 2005). For that reason, an organisation's executives need to determine how a firm can compete so that it can obtain advantages that are sustainable in the long term (Dess et al., 2005).

Phase III consists of externally oriented planning (strategic planning). Top management takes control of the process and initiates strategic planning with political and other external influences being considered (Gluck et al., 1982).

Phase IV involves strategic management. Top management forms planning groups from managers and key employees at many levels from various departments and work groups in order to gain the commitment of lower level managers (Gluck et al., 1982). The process includes the analysis of strategic goals, followed by the analysis of the internal and external environment of the organisation (Dess et al., 2005). Dess et al. (2005) go on to say that leaders use these analyses to make strategic decisions. Firms then would need to take the necessary actions to implement their strategies by allocating

resources and structuring the organisation to ensure that the strategies produce outcomes (Dess et al., 2005).

The next group of stakeholders is the employees. As mentioned before, 58 779 NFP organisations employ 889 900 staff, making up around 8 percent of employment in NFP organisations in 2006–07 (Productivity Commission, 2010). Employees play a vital role in the NFP sector and that is why senior management realises that for strategic plans to be effective, input and commitment from all employees is required (Gluck et al., 1982).

Another very important stakeholder group is the volunteer. Voluntary work has been defined as “work without monetary pay or legal obligations provided for persons outside the volunteer’s own household” (Anheier, 2005, p. 219). There are two categories of volunteers (Inglis & Cleave, 2006). The first category is responsible for the governance of NFP organisations, while the second category of volunteers help out in the program or service of a NFP organisation (Inglis & Cleave, 2006).

Tonkiss and Passey (1999) suggest that the core feature of a NFP organisation is voluntarism, although, as mentioned above, this was disputed by Anheier (2000). According to the Productivity Commission (2010), 4.6 million Australians volunteered with NFPs in 2006–07. The wage equivalent value was \$14.6 billion (Productivity Commission, 2010). These two figures show the magnitude of the volunteers’ role in NFP organisations in Australia.

Volunteers play a vital role in NFP organisations all over the world. In Germany, in 1995, 3 percent of all workers were employed in the NFP sector, along with 2.5 million volunteers, nearly tripling the number of paid employees (DiRusso, 2011). In Italy, a vast majority of NFP organisations depend on volunteers to provide their services. It is estimated that about 3.2 million volunteers and 630 000 paid employees service the NFP sector in Italy (DiRusso, 2011). Of the 250 000 NFP organisations, only 15.2 percent have paid employees, making volunteers vital in the delivery of services provided by NFP organisations (DiRusso, 2011).

Having explored, the roles and responsibilities of stakeholders in NFP organisations, the focus will be turned to the many tax concessions that NFP organisations enjoy in Australia.

#### **2.4.4 Tax concessions for NFP organisations in Australia**

Receiving tax concessions is another important feature of a NFP organisation (DiRusso, 2011; Glaeser, 2003; Smith, 2001). In Australia, there are many tax concessions available to the NFP sector. Some NFP organisations do not have to pay income tax and they can also receive tax-deductible donations (ATO, 2011b).

This is also the case in other countries. The French tax law provides certain benefits for organisations that serve the public interest, such as a NFP organisation, and allows for partial income tax exemptions for donors to charitable organisations (DiRusso, 2011).

In Bangladesh, the Finance Act of 1999 levied a 25 percent tax on the commercial income of NFP organisations and allowed the rest of the income to be redirected to its NFP activities (DiRusso, 2011). A range of tax concessions are available to NFP organisations in Australia, while only a few of the concessions can be accessed by all NFP organisations.

NFP organisations are grouped by the ATO according to the following categories:

- registered public benevolent institutions and registered health promotion charities
- registered charities
- income tax exempt funds
- other non-profit organisations. (ATO, 2011a)

There are also concessions for:

- public and NFP hospitals and public ambulance services

- religious institutions and GST concessions for charities, gift deductible entities and government schools
- NFP companies and live-in residential care workers. (ATO, 2011a)

The following is a summary of tax concessions and types of NFP organisations:

1. Registered public benevolent institutions and registered health promotion charities.
  - The organisation must be endorsed by the ATO to access income tax exemption, fringe benefits tax (FBT) exemption (subject to capping threshold), goods and services tax (GST) concessions for charities and gift deductible entities.
  - The organisation must be endorsed by the ATO as a deductible gift recipient to access this concession. The only organisations that do not need to be endorsed are those listed by name in the tax law.
  - The organisation must be an entity that is endorsed by the ATO as exempt from income tax or a deductible gift recipient to access refunds of franking credits. (ATO, 2011a)
2. Registered charities.
  - The organisation must be endorsed by the ATO to access income tax exemption and GST concessions for charities and gift deductible entities.
  - Certain types of these organisations must be endorsed by the ATO to be a deductible gift recipient to access this concession. The only organisations that do not need to be endorsed are those listed by name in the tax law.
  - The organisation must be an entity that is endorsed by the ATO as exempt from income tax or a deductible gift recipient to access refunds of franking credits. (ATO, 2011a)

### 3. Income tax exempt funds.

- The organisation must be endorsed by the ATO to access income tax exemption and GST concessions for charities and gift deductible entities.
- The organisation must be a deductible gift recipient to access GST concessions for charities and gift deductible entities.
- The organisation must be endorsed by the ATO as a deductible gift recipient to access this concession. The only organisations that do not need to be endorsed are those listed by name in the tax law.
- The organisation must be an entity that is endorsed by the ATO as exempt from income tax or a deductible gift recipient to access refunds of franking credits. (ATO, 2011a)

### 4. Other non-profit organisations.

- Only certain types of NFP organisations are exempt from income tax. Many NFP organisations are taxable, but may be entitled to special rules for calculating taxable income, lodging income tax returns and special rates of tax.
- Public and NFP hospitals and public ambulance services are eligible for FBT exemption (subject to capping threshold).
- Certain non-government NFP organisations are eligible for FBT rebate.
- The organisation must be a deductible gift recipient to access GST concessions for charities and gift deductible entities.
- Certain types of these organisations must be endorsed by the ATO as a deductible gift recipient to access this concession. The only organisations that do not need to be endorsed are those listed by name in the tax law.
- The organisation must be an entity that is endorsed by the ATO as exempt from income tax or a deductible gift recipient to access refunds of franking credits. (ATO, 2011a)

As can be seen above, there are a large number of tax concessions available for NFP organisations in Australia, as there is elsewhere in the world and as stated by Glaeser (2003). Tax concessions are an important assistance provided by the government to the NFP sector. These concessions are given to allow organisations that are not in operation to generate profits for their members but to provide a service to community to continue their operation at a lower cost. These tax concessions can be withdrawn if a NFP organisation is seen to be operating like a FP enterprise.

In the US, 13 states considered changes in the tax-exempt status of NFP hospitals because they were not providing significant amounts of free health to the poor (Coble, 1999). According to Shamima (2005), several cities in the US withheld zoning approval and building permits for new developments unless NFP universities, hospitals, or symphony orchestras in the zone agreed to pay a voluntary tax. Tax can be used as a negotiation tool for all sectors and the NFP sector is not excluded. This can be in the form of existing tax concessions, by introducing a new tax, or by reforming current taxes.

The next section will focus on the definition of large and small FP firms and NFP organisations. It will be followed by other comparisons of FP to NFP organisations.

## **2.5 Classification of NFP organisations**

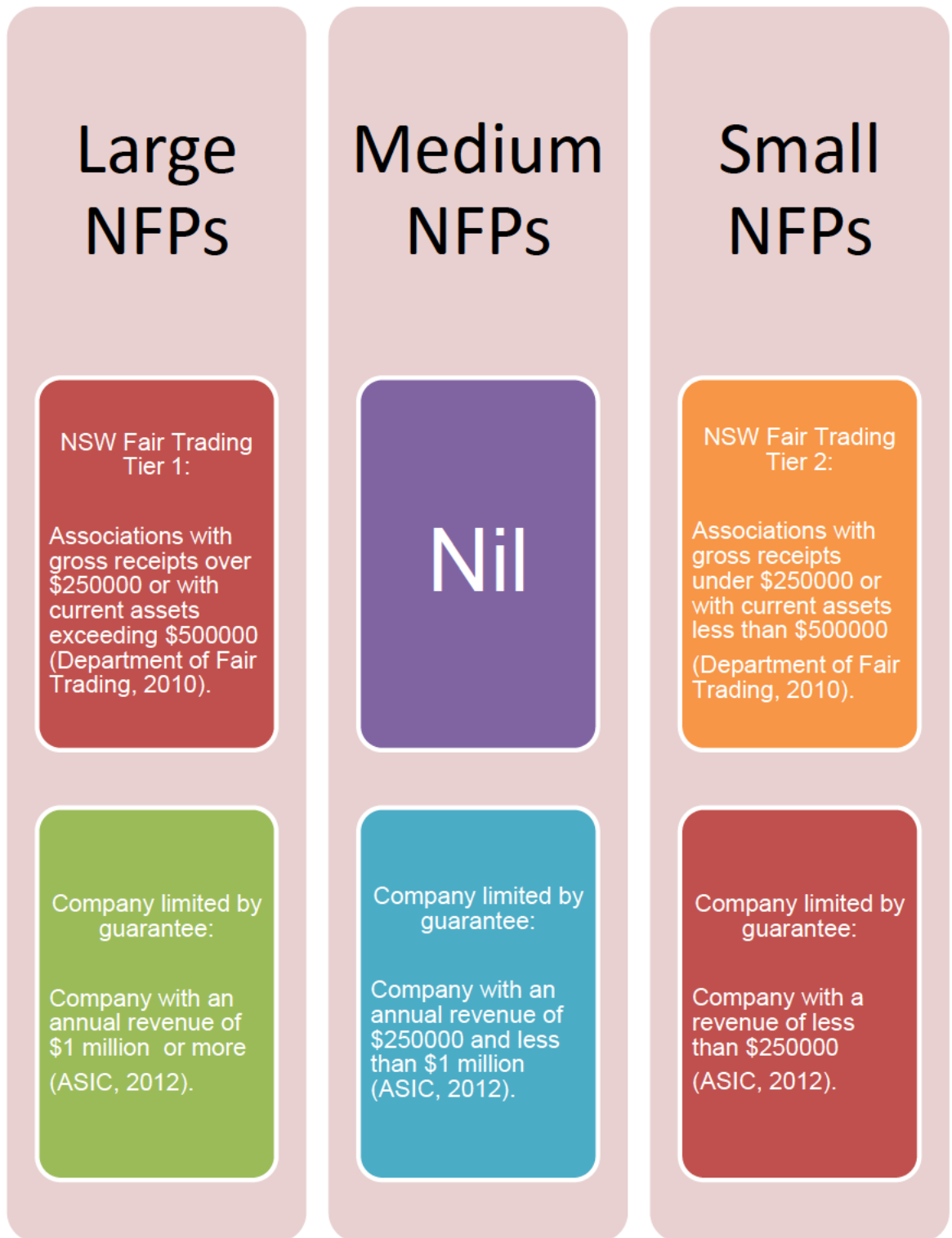
### **2.5.1 Definitions**

This section discusses the different sizes of NFP organisations registered through state and federal agencies. As mentioned above, in this study, NSW will be used when discussing state registration. This section then compares small and large companies alongside small and large NFP organisations.

According to the NSW Fair Trading, large NFP organisations are classified as Tier 1 and small NFP organisations as Tier 2. Tier 1 associations have

gross receipts of over \$250 000 or with current assets exceeding \$500 000. Tier 2 organisations are associations with gross receipts of under \$250 000 or with current assets less than \$500 000.

The federal government's administering agency for NFP organisation is ASIC. ASIC classifies NFP organisations into three categories as can be seen in the figure below. Figure 2.1 below compares NFP organisations classified under NSW Fair Trading and ASIC.



**Figure 2.1: A comparison of Incorporated Associations and Companies Limited by Guarantee**

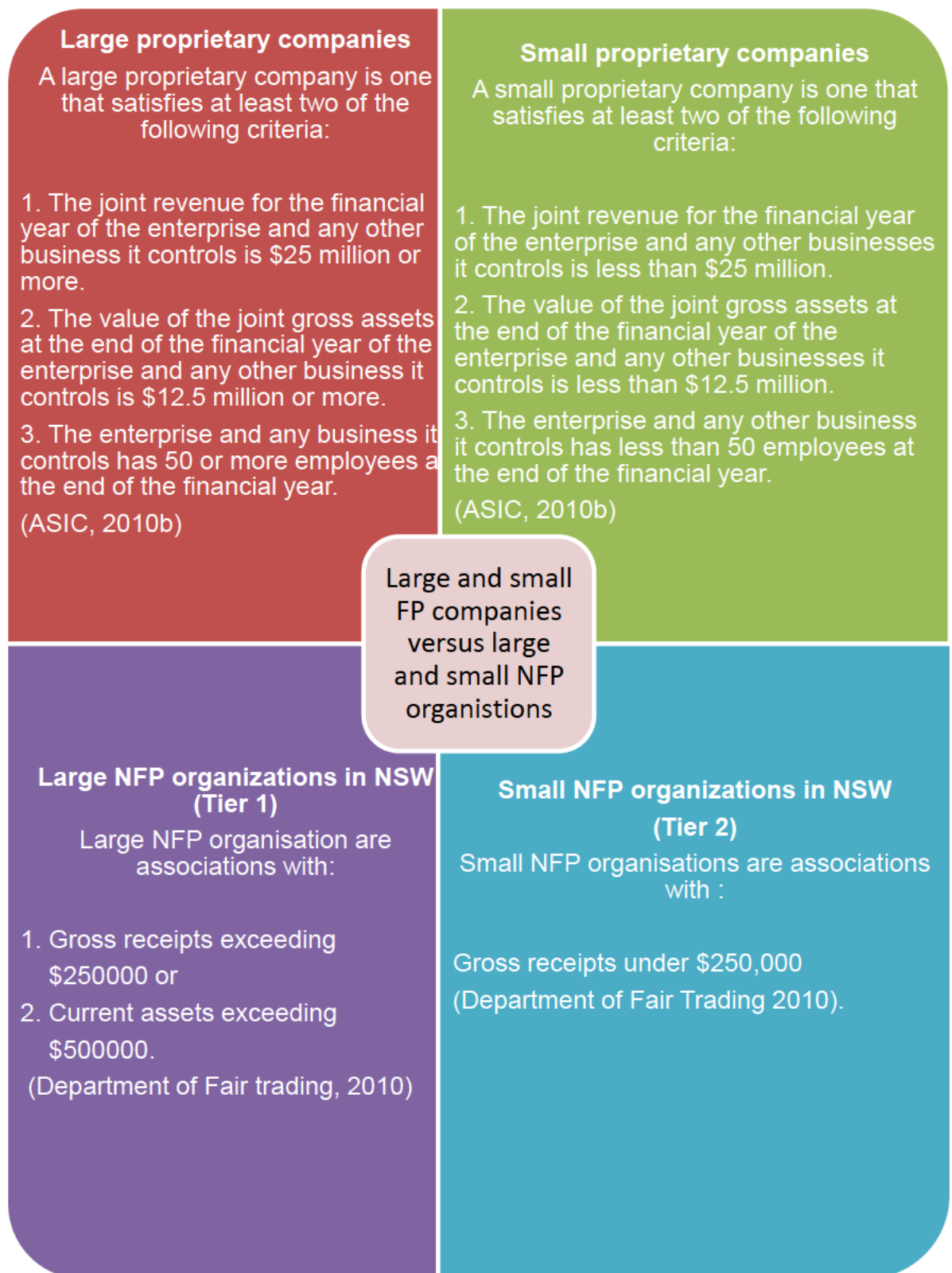
What is missing in the NSW Fair Trading definition is the classification for associations with gross receipts of exactly \$250 000 or with current assets of exactly \$500 000. In the current classification, associations with gross receipts of \$250 000 or with current assets of \$500 000 do not fall in to either Tier 1 or 2 (Department of Fair Trading, 2010).

According to ASIC, a small NFP organisation is one with a revenue or consolidated revenue for the financial year of less than \$250 000 (ASIC, 2012). A NFP organisation is considered medium if it is not a small registered entity for the financial year, and the revenue of the registered entity for the financial year is less than \$1 000 000. A NFP organisation is considered large for a financial year if it is not a small registered entity or a medium registered entity (ASIC, 2012). The ACNC's classification of NFP organisations is the same as ASIC's classification of small, medium and large.

Since NSW Fair Trading, ASIC and ACNC's classification of small NFP organisation is organisations with revenue of less than \$250 000 in the financial year, this research will adopt that classification. The sample chosen for this research will also be of NFP organisations with revenue of less than \$250 000 a year.

There are other types of companies, such as, but not limited to, sole traders and partnerships and trusts (ASIC, 2014b). These types of businesses are not within the scope of this study.

In figure 2.2 below, small and large companies are compared to small and large NFP organisations. NSW Fair Trading definition is taken to make this comparison because, as mentioned above, ASIC classifies NFP organisations into three categories. For greater clarity, ASIC's large and small companies and NSW Fair Trading's large and small NFP organisations are used in the comparison below.



**Figure 2.2: A comparison of large and small companies versus large and small NFP organisations**

The following section will discuss the reporting requirements of FP companies and NFP organisations.

### **2.5.2 Financial reporting requirements**

NFP organisation's comparative behaviour and performance with FP companies and public organisations is a fundamental topic of discussion in the literature (Ben-Ner, 2004). This is especially applicable in industries where NFP organisations co-exist and compete with other organisational structures (Ben-Ner, 2004). There have been comparative behaviour studies done in the hospital industry, but the findings do not present the answer to the desirability of each sector from the viewpoint of customers, policy makers and other stakeholders (Ben-Ner, 2004). Therefore, moving on from how the four business structures are defined, the reporting requirements of each of the definitions above need to be investigated.

The reason NFPs are compared to FPs in this section is because of the growing commercialisation in the NFP sector, which is seen as ironic, because commercialisation is usually linked to the FP sector (Weisbrod, 1998). However, NFP organisations in the human service industry are becoming increasingly involved in commercialising their services (Guo, 2006).

Figure 2.3 below illustrates the four business structure's reporting requirements. The *Associations Incorporation Act*, which is governed by NSW Fair Trading, provides NFP organisations a simple and more affordable means of creating a separate legal entity for small entities with limited resources. It is believed that the *Associations Incorporation Act* impose less onerous conditions than the *Corporations Act 2001* that governs the activities of companies (ASIC, 2010a).

The *Corporations Act 2001* requires public companies, disclosing entities, large proprietary companies, managed investment schemes, small proprietary companies that are foreign-controlled and small proprietary

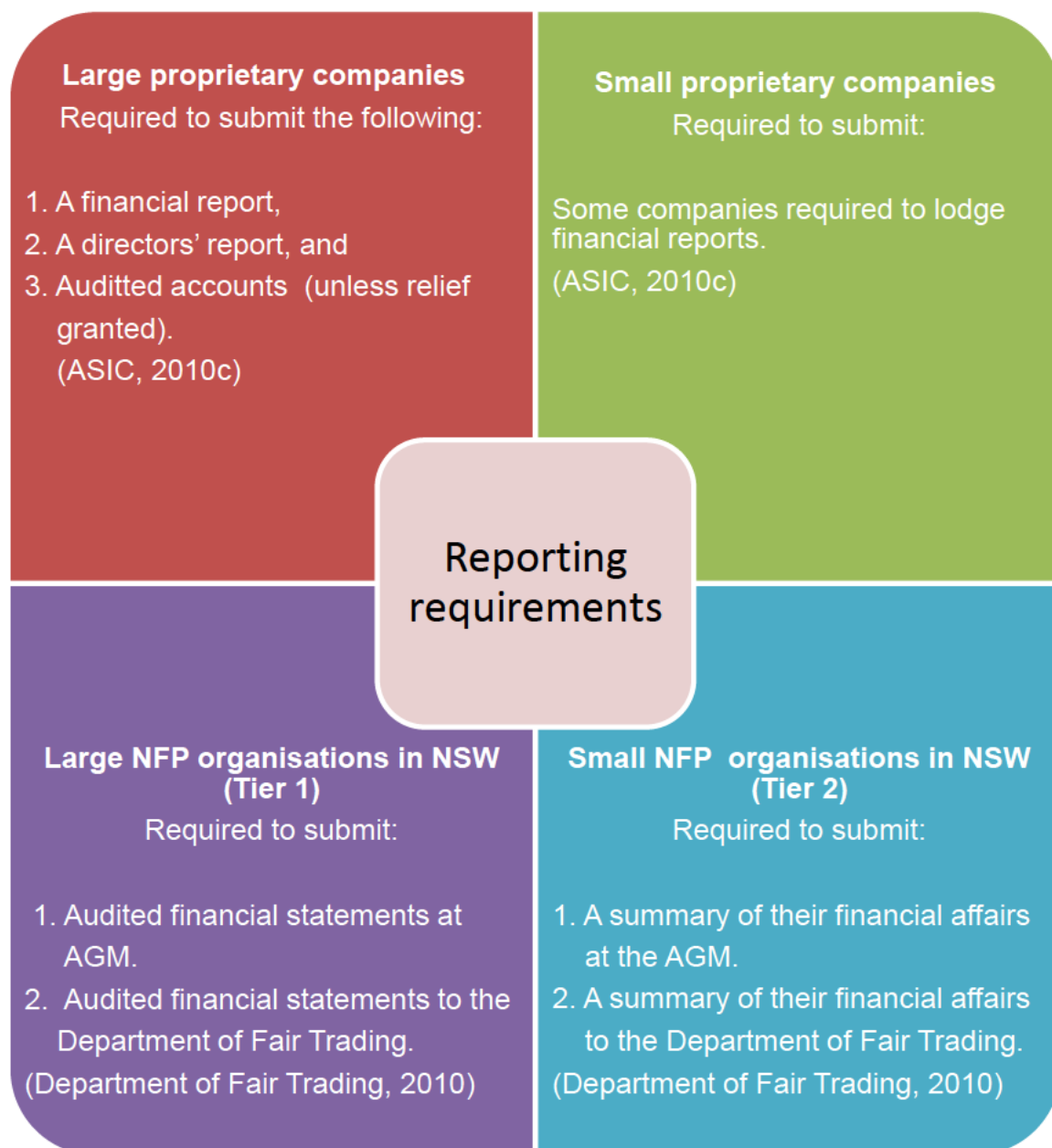
companies that are instructed by ASIC to prepare financial reports (ASIC, 2010c).

ASIC does not imply that other companies do not need to keep financial records. In fact all companies are expected to keep financial records to ensure they understand how their operations are fairing. However, there are some types of companies that need to keep financial records for the purposes of preparing and lodging them with ASIC (ASIC, 2010c).

NSW Fair Trading has specific financial reporting regulations based on the *Associations Incorporation Act 2009*, which divides associations into two categories for reporting purposes. From 1 July 2010, associations with gross receipts exceeding \$250 000 or with current assets exceeding \$500 000, which are referred to as Tier 1 associations, are required to submit audited financial statements each year to their members at the AGM (Department of Fair Trading, 2010).

Smaller organisations, which are referred to as Tier 2 associations, with gross receipts of under \$250 000, are only required to submit a summary of their financial affairs at the AGM (Department of Fair Trading, 2010). Even if legislation does not require organisations with gross receipts of under \$250 000 to have their accounts audited, some NFPs will need to audit their accounts if this is stipulated in the organisation's constitution or required by their funding body. Good governance dictates that all NFP organisations keep clear, accountable and transparent financial records.

Once again, since organisations with revenue of \$250 000 or with current assets of \$500 000 are not classified in either Tier 1 or 2, there is no instructions as to whether they need to only have a summary of their financial affairs at the AGM, or if they are required to submit audited financial statements each year to their members at the AGM.



**Figure 2.3: Financial reporting requirements of the four business structures**

NSW Fair Trading's requirement is different from those of ASIC and the ACNC. According to ASIC, small NFP organisations do not have to prepare a financial report or have it audited, prepare a directors' report, or notify members of annual reports unless directed by a member or ASIC.

Medium-sized NFP organisations must prepare a financial report, can elect to have its financial report reviewed rather than audited, must prepare a directors' report, although with less detail than that required of other

companies, and lastly must give annual reports to any member who elects to receive them. Large NFP organisations must have the financial report audited, must prepare a directors' report, although with less detail than that required of FP companies, and must give annual reports to any member who elects to receive them (ASIC, 2012).

According to ACNC (2012), all three sizes of NFP organisations must provide the Commissioner with an annual information statement, while medium and large organisations must also provide the Commissioner with a financial report. These financial reports need to be reviewed for medium entities or audited for large entities.

Another important difference amongst the four structures is the issue of ownership and control. This will be discussed in greater detail in the section below.

### **2.5.3 The separation of ownership and control**

The original theory on separation and ownership of listed companies stems from Berle and Means's agency theory research on modern corporations in 1932 (Trick, 2015, Brennan & Solomon, 2008). The concept of absentee ownership became more apparent after World War II, when American corporations began to thrive (Alkhafaji, 2007).

Much has been written about agency theory since then with a focus on resolving conflicts of interest between management that controls the business and the shareholder who owns the business (Eisenhardt, 1989; Fama, 1980; Fama & Jensen, 1983; Jensen & Meckling, 1976; Van Puyvelde et al., 2012). Agency theory will be discussed in greater detail in the literature review chapter.

In this section, the issue of the separation of ownership and management is discussed to show that this issue is linked to corporate governance. Corporate governance is a set of mechanisms that protect the interest of

investors. This protection is against expropriation by managers and the controlling shareholders (La Porta et al., 2000).

The key difference between the stakeholders of FP and NFP organisations is the problem of identifying the true owners of NFP organisations (Ben-Ner, 2004; Turbide, Laurin, Lapierre, & Morissette, 2008). Some writers believe that there is a need to identify the stakeholders represented by the Board of Directors, even if the owners cannot be determined (Houle, 1989). Similarly, Miller (2002) is of the opinion that in order to examine the governance of NFP organisations, it is first important to establish who the principal is (Miller, 2002). There have been concerns raised by economists when decisions are made by managers who are not the firm's owners (Fama, 1980).

As mentioned above, according to the Productivity Commission (2010), although NFPs are created for a community purpose, the direction they take is determined by how the members initially set it up. Therefore, without there being actual owners, in a NFP organisation, members elect the board just like shareholders elect their board in a FP company.

For that reason, when discussing the issue of ownership and control or agency theory, the two interests in the discussion are the interests of members and the people who control the organisation, which are the board and CEO. In the case of NFP organisations, the people who control an organisation are the Board of Directors and the CEO or manager, while the people who 'own' the organisation are the members. When the interests of the members and the people who control the organisation are not aligned, expropriation can occur.

According to La Porta et al. (2000), expropriation can take many forms, such as:

- insiders embezzling profits
- insiders selling off assets to a firm they own at below market price

- insiders diverting corporate opportunities that come to a NFP organisation they control to other businesses they own
- insiders employing family members who are not qualified in managerial positions
- insiders overpaying executives.

According to La Porta et al. (2000), the issue of expropriation is connected to the agency problem described by Jensen and Meckling (1976).

Since the members are not present in the organisation on a day-to-day basis, there is the need for the person or people who control the organisation to act in the best interests of the owners. In a NFP organisation, when the CEO or the Board of Directors fails to act in the best interests of the members, agency problems increase, which then raises agency costs.

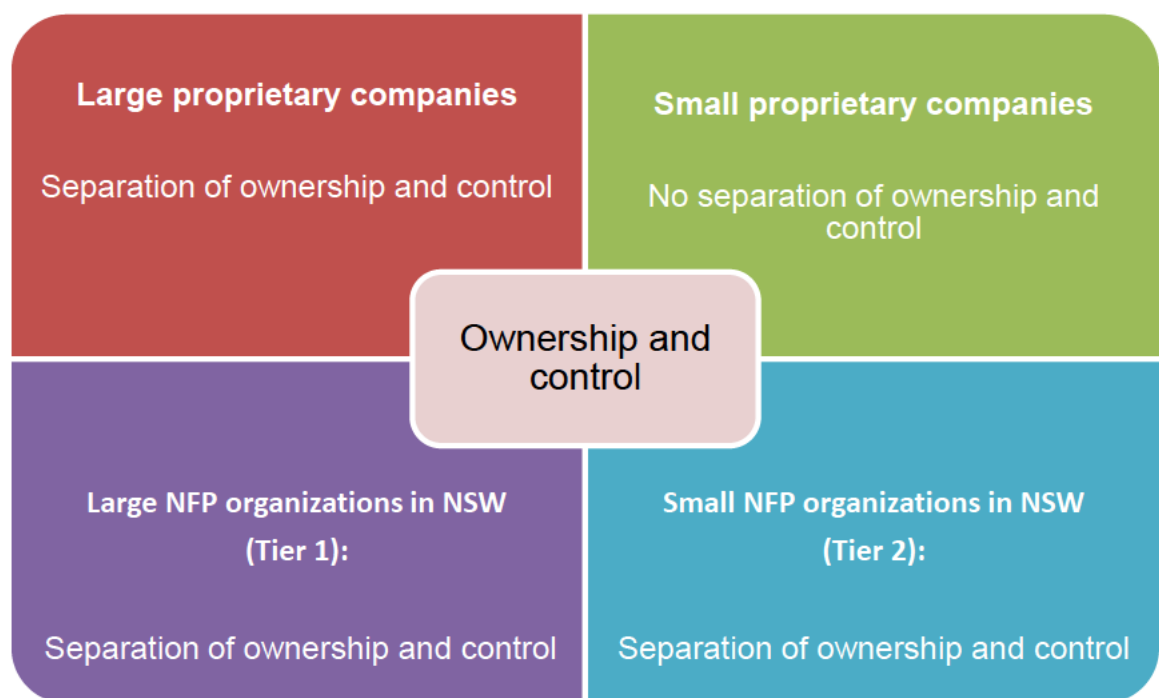
There is a perceived expectation that the person or people who control the organisation will act in the best interest of the owners. In reality, this is not always the case, hence, there is a need for financial controls and governance mechanisms, such as a code of conduct and best practice models, to ensure that the people who control a NFP organisation act in the best interests of its members and not in their own personal interests.

In a NFP organisation, whether it is large or small, control and ownership is similar to a large company, because there is a clear separation of members and control. Fama and Jensen (1983) argue that the separation of ownership which is the risk-bearing function and control which is the decision-making function which is a feature of large corporations is also a feature of NFPs. The separation of ownership and control is not a problem for large NFP organisation, and companies, because they are monitored by way of an annual audit and stringent reporting requirements to the administering bodies, such as NSW Fair Trading or ASIC.

This type of monitoring is not required for a small NFP organisation. The issue of separation of ownership and control is a problem for small NFP

organisations. The type of monitoring required for large companies and large NFPs is not necessary for a small company, because the owner runs the company and controls it. There is no separation of ownership and control. The owner is expected to operate his or her company for his or her best interests.

The only type of business structure that can be affected by the separation of ownership and control is small NFP organisation, as shown in Figure 2.4 below, which illustrates the ownership and control of each of the four structures being discussed.



**Figure 2.4 Ownership and control of the business structures**

## 2.6 Conclusion

In conclusion, one can say that the NFP sector is a large sector that contributes economically to Australia, be it in employment, the varied services it offers or the training of staff and volunteers it provides. This very strong sector has over 600 000 organisations.

The literature used in the above sections indicates that the NFP sector plays a vital role in sustaining a cohesive society and a strong economy especially because it provides services on behalf of the government. NFP organisations have legal structures and the Australian Government continues to actively look into reforming this sector. Since the NFP sector emerged in the Australian economy in 1813, it has grown from strength to strength, contributing \$43 billion to Australia's GDP in 2006–07.

This chapter also established that NFP organisations are allowed to make profits, but the profits are channelled back into the organisation as surplus rather than distributed to their members. The different classifications of NFP organisations and their reporting requirements were investigated. It was discovered that the only business structure that is affected by the separation of ownership and control are small NFP organisations. Furthermore, these small NFPs are not closely regulated or monitored by their administering bodies, such as NSW Fair Trading or ASIC.

The purpose of this chapter was to provide industry-related background information about the NFP sector while the next chapter will focus on the literature review.

## **Chapter 3: Literature Review**

### **3.1 Introduction**

The previous chapter focused on industry-related background information on NFP organisations to better understand the sector and the research. Although this is an academic study, findings from the research will have a very practical impact on this sector. For that reason, a good understanding of the NFP sector is vital for achieving the stated research goals.

This chapter in Section 3.2 brings the focus specifically to the literature in the area of corporate governance in the for-profit (FP) and not-for-profit (NFP) sectors. This section also discusses corporate governance in FP companies, such as codes, legislation and reports that have been introduced in other countries to improve corporate governance practices in FP companies. Elements of these practices that can be used for small NFP organisations will be highlighted. The accounting standards body that has the responsibility for the development of accounting standards for NFP organisations will also be discussed in this section.

After studying the financial and corporate governance measures that currently exist in the FP sector, the study will focus on corporate governance issues in NFP organisations. Issues such as trust, accountability, fiduciary responsibilities, agency theory, and the lack of checks and balances for small NFP organisations will be discussed. The purpose of this section is to show the need for good corporate governance measures in the NFP sector like the ones in the FP sector that were discussed earlier in the section.

Section 3.3 will bring the focus to the gaps in the existing literature, particularly in corporate governance for small NFP organisations within the Australian context. Some of the issues in small NFP organisations that were raised in Chapter Two will be re-visited to link it to the gap that exists in the literature.

Sections 3.4 and 3.5 will establish the need for this study and how financial control and governance mechanisms can be used in the successful financial management of a small NFP organisation in Australia. The hypotheses and research questions for this study will also be disclosed.

The following section will begin with the definition of corporate governance.

## **3.2 Corporate governance**

Corporate governance is an extensive subject and this chapter will start with a study of what governance is and the different types of corporate governance models that are currently in use. There will also be a discussion on what type of model best suits small NFP organisations.

### **3.2.1 What is corporate governance?**

#### **i) Definition of corporate governance**

Corporate governance in the NFP sector is an emerging field (Dawson & Dunn, 2006). Dawson and Dunn (2006, p. 33) state that in academic literature as well as in practice, the attempt to offer governance in the NFP sector is “discrete and disparate”. This seems to be the case for small NFP organisations, as there is no literature on corporate governance best practice for them. The first step in exploring corporate governance is to investigate its definition, followed by who is responsible for it and lastly the different models of corporate governance. A few popular definitions of corporate governance are outlined below.

There is a clear difference between management and governance. Management is the act of running an organisation, while governance is the direction that the organisation takes which includes the formulation of strategy and policy (Tricker, 2015)

In neoclassic economic research, governance is defined mainly as a means of protecting investors (Bushman & Smith, 2001; La Porta et al., 2000; Shleifer & Vishny, 1997). The importance of investor protection is evident in

a number of other countries such as Germany (Edward & Fischer, 1994; Gorton & Schmid, 2000) and Italy (Barca, 1995). This view is expanded by Shleifer and Vishny (1997) when they say that corporate governance is an instrument that safeguards the interests of investors by guaranteeing that they get a return on their investment.

According to the United Nations Economic and Social Commission for Asia and the Pacific (2010), the concept 'governance' means the process of decision-making and the process by which decisions are implemented or not implemented. This definition holds good for both FP companies and NFP organisations.

Lynall, Golden, and Hillman (2003) defined corporate governance as a set of mechanisms. These mechanisms are used to manage the relationship among stakeholders to determine and control the strategic direction and performance of organisations (Considine et al., 2014; Lynall et al., 2003). There is a similar understanding by Desai, Kroll and Wright (2005) when they state that corporate governance is concerned with identifying ways to ensure that strategic decisions are made effectively.

Corporate governance is defined by the Advisory Board of the National Association of Corporate Directors in Australia as the process to ensure that long-term strategic objectives and plans are established (Bleicher & Paul, 1986). It also ensures that the proper management structure, which includes organisations, systems and people, is in place to achieve those objectives. At the same time, it makes sure that the structure functions to maintain the corporation's integrity, reputation and responsibility to its various stakeholders (Bleicher & Paul, 1986).

Corporate governance is also defined as the institutional guideline that controls the division and exercise of power in the company (Licht, 2011). For that reason, Licht (2011) states that power is the main concept in corporate governance. By this, Licht (2011) takes the position that the effective

institutional guideline will ensure that a corporation functions efficiently and properly.

Corporate governance is also defined as the group that distributes the rights and responsibilities amongst the different stakeholders engaged in an organisation (Aguilera & Jackson, 2003). Due to the fact that governance in any sector with different stakeholders will produce conflicts of interests, mechanisms must be created to manage these pluralist interests so as to align the interests of management and owners (Aguilera, 2005).

The above definitions of corporate governance seem to be looking at the term from different angles. It is important to determine the core meaning of corporate governance for the NFP sector. For this reason, the key ideas in the definitions above have been extracted and tabled below. The purpose is to identify the underlying theme or themes for each of the definitions above. By identifying the key themes, their suitability for the NFP sector can be determined.

**Table 3.1 Themes and key ideas for the definition of corporate governance**

<b>Theme</b>	<b>Sector</b>	<b>Key ideas</b>
<b>Protection of investors and their interest</b>	FP	<ul style="list-style-type: none"> <li>• protecting investors (Bushman &amp; Smith, 2001; La Porta et al., 2000; Shleifer &amp; Vishny, 1997)</li> <li>• guaranteeing that they get a return on their investment (Shleifer &amp; Vishny, 1997).</li> </ul>
<b>Decision-making</b>	FP/NFP	<ul style="list-style-type: none"> <li>• process of decision-making and the process by which decisions are implemented or not implemented (United Nations Economic and Social Commission for Asia and the Pacific,</li> </ul>

		2010).
<b>Stakeholder relationship and strategic decisions</b>	FP/NFP	<ul style="list-style-type: none"> <li>mechanisms used to manage the relationship among stakeholders (Lynall et al., 2003)</li> <li>to determine and control the strategic direction and performance of organisations (Considine et al., 2014; Lynall et al., 2003)</li> <li>identifying ways to ensure that strategic decisions are made effectively (Desai, Kroll, &amp; Wright, 2005).</li> </ul>
<b>Long-term strategic objectives</b>	FP/NFP	<ul style="list-style-type: none"> <li>process to ensure that long-term strategic objectives and plans are established (Bleicher &amp; Paul, 1986)</li> <li>ensures that the proper management structure, which includes organisations, systems and people, is in place to achieve those objectives (Bleicher &amp; Paul, 1986)</li> <li>structure functions to maintain the corporations integrity, reputation, and responsibility to its various stakeholders (Bleicher &amp; Paul, 1986).</li> </ul>
<b>Controls the exercise of power</b>	FP/NFP	<ul style="list-style-type: none"> <li>guideline that controls the division and exercise of power in the company (Licht, 2011)</li> <li>power is the main concept (Licht, 2011)</li> <li>ensure that a corporation functions efficiently and properly (Licht, 2011).</li> </ul>
<b>Rights &amp; responsibilities</b>	FP/NFP	<ul style="list-style-type: none"> <li>distributes the rights and responsibilities amongst the different stakeholders engaged in an organisation (Aguilera &amp;</li> </ul>

		<p>Jackson, 2003)</p> <ul style="list-style-type: none"> <li>• need mechanisms to align the interest of management and owners (Aguilera, 2005).</li> </ul>
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Two definitions from the table above will be left out. The first definition that will be omitted is the definition with the theme, *protection of investors and their interest* because the NFP sector does not have investors in the same way as the FP sector. The second theme that will not be selected is *controls the exercise of power*, for the reasons provided below.

Although the Board of Directors of any organisation is considered to have dual duty of controlling and providing direction (Aguilera, 2005; Considine et al., 2014; Forbes & Milliken, 1999; Nicholson & Kiel, 2004; Petrovic, 2008), the aspect of control is in the context of supervising the CEO for the stakeholders (Monks & Ninow, 2011) and not, as Licht (2011) indicated, to exercise power. For this reason, controls for the exercise of power will be left out. However, the second part of the definition that indicates that corporate governance ensures that a corporation functions efficiently and properly (Licht, 2011) is very valuable and so, will be used.

From the definitions above that are being used, one can state that corporate governance in a NFP organisation is the process of making corporate decisions to protect the rights of all stakeholders by exercising corporate power that aligns all stakeholders' interests with the long-term strategic objectives of the organisation.

## **ii) Corporate governance responsibilities**

Corporate control of an organisation is the duty of the Board of Directors (Aguilera, 2005; Considine et al., 2014). Boards are the internal body that shapes firm governance, especially because they have access to both management and the owners (Aguilera, 2005), and in the case of the NFP

sector, the board has access to management and the members. Boards play a vital role in improving corporate governance (Aguilera, 2005).

For the reasons mentioned above, the performance of an organisation is attributed to the Board of Directors (Aguilera, 2005; Considine et al., 2014). Positive contributions by the board are expected when the organisation performs effectively (Considine et al., 2014). Researchers have tried to better understand the behaviours involved in effective board performance (Forbes & Milliken, 1999).

The existing literature states that the governance of any NFP organisation is the responsibility of the Board of Directors. Therefore, a governing board has ultimate corporate accountability. A governing board with limited resources and insufficient staff usually functions as a workgroup board or management board, as it must govern and be the workforce at the same time (Carver, 2006).

As mentioned in the previous section, the governing Board of Directors of any organisation is considered to have dual responsibilities, which are to control it and provide direction (Aguilera, 2005; Considine et al., 2014; Forbes & Milliken, 1999; Nicholson & Kiel, 2004; Petrovic, 2008). In this context, 'control' refers to the board's legal responsibility to supervise management for stakeholders (Monks & Ninow, 2011). Monks and Ninow (2011) contend that the board is expected to carry out their responsibilities with loyalty and care. Following on from the board's responsibility to control the organisation is their responsibility to provide strategic direction for the organisation's long-term sustainability (Petrovic, 2008).

### **iii) Models of corporate governance**

New structures and designs for NFP governance have been explored by many academics (Block, 2007; Freiwirth & Letona, 2006; Renz, 2006). To avoid an 'anything goes' approach, Bradshaw (2009) suggests going back to the normative approaches. They are the policy governance model, the

constituency model, the emergent cellular model and the entrepreneurial model (Bradshaw, Hayday, Armstrong, Levesque, & Rykert, 1998; Marx & Davis, 2012a). Thus, the four models above are generally accepted as the normative approaches of corporate governance.

The policy governance model is considered to be the dominant model and is based on the supposition of separation of power between the board and the CEO (Bradshaw, 2009; Bradshaw et al., 1998; Marx & Davis, 2012a). It further states that the board's role is as a trustee on behalf of its communities, and the board ensures responsiveness to these stakeholders through the articulation of a clear vision and set of values. Assumptions made include the possibility of long-term planning and the clarity of roles to avoid power struggles (Bradshaw et al., 1998; Marx & Davis, 2012a).

In the policy governance model, ends or goals are carefully considered and set out. The board sets the financial and ethical parameters in which the organisation operates (Carver, 2006). The CEO is empowered to see that the goals of the organisation are implemented through either volunteers or staff. In this model, there is a clear line of authority, with the staff and volunteers reporting to the CEO and the CEO being accountable to the board. Board meetings become a time where although achievements are celebrated, unreached goals are examined and short-term and long-term plans refined and renewed (Carver, 2006).

This governance model may appear to be limiting to some because of the top-down control that may result in constraints by a managerial or business mindset (Bradshaw et al., 1998). There have been concerns that there is a risk that the board will become less responsive to community needs and more concerned with issues such as productivity, output measures and accountability rather than public interests (Bradshaw et al., 1998).

The literature indicates that the policy governance model is very goal oriented and may be what small NFP organisations need. It is important that the board leads the organisation by setting the financial and ethical

parameters, especially because the board is ultimately responsible for its fiduciary responsibilities.

The second governance model is the constituent or representative board model (Bradshaw et al., 1998). In this model there is an obvious connection between the organisation's board and its constituents, who are normally represented on the governing board and participate in policy development and strategic direction (Bradshaw et al., 1998). This model is more inclusive and consists of a greater number of board members. Centralised decision-making and decentralised power seem to be another key feature of this model. The board empowers the CEO to manage and run the day-to-day matters of the organisation within the limitations set by the board. Due to the large board-based structure, good, timely and clear communication is vital for the success of this governance model (Bradshaw et al., 1998).

The constituency model is good in that the board empowers the CEO to manage daily operational matters and sets perimeter for the CEO. However, this model has a large number of board members. A small NFP organisation has a turnover of less than \$250 000 and this calls for a small group of focused board members who are well versed with the objectives and running of the organisation to be able to meet its objectives. A large board-based structure may be more appropriate for organisations with varied programs that allow for a larger group of people with all the appropriate skills to be involved. For that reason, this structure may not be appropriate for small NFP organisations in Australia.

The third governance model is called the emergent cellular model. This is characterised by distributed networks that are made up of cells. These cells could be made up of self-managing teams, autonomous business units or operational partners that can operate alone but can also network with other cells to produce a more forceful and proficient organisational mechanism (Bradshaw et al., 1998). This special co-dependence allows teams in the emergent cellular model to generate and share the knowledge that produces

continuous innovation (Miles, Snow, Mathews, Miles, & Coleman, 1997). This is a newer model and not as developed as the other models.

The emergent cellular model allows for self-managing teams or autonomous business units. This may be inappropriate for organisations that are small with limited manpower, limited income and limited resources. It is more appropriate for organisations that have a large staff, which includes a large middle management. Each manager can take responsibility for a business unit and report to the CEO. A small NFP organisation may not be able to afford even a single middle manager. The CEO or manager may have to run the operation, solely relying on volunteers (Suhod et al., 2006).

The last governance model is the entrepreneurial model, which is also referred to as the corporate model of governance (Bradshaw et al., 1998). In this model, the focus is on innovation, efficiency, effectiveness measures and a market orientation to find opportunities and competitive advantages. Within this framework, plans are driven by annual short-term and three to five year longer-term plans. The Chair of the Board of Directors is often the Chief Executive Officer of the organisation (Bradshaw et al., 1998).

Market orientation is important for a small NFP organisation, because it reflects the degree to which the small NFP organisation's strategic market planning is driven by external factors such as customer and competitor intelligence (Baker & Sinkula, 2009). The direct effect of market orientation is on firm profitability (Baker & Sinkula, 2009).

In conclusion, one can say that both the policy governance and entrepreneurial models are most appropriate for small NFP organisations. The policy governance model is fitting for small NFP organisations because the board sets out the organisation's vision, mission and values. It also sets out a clear separation of roles to avoid power struggles. The board takes a leadership role by setting financial and ethical parameters and examining unattained goals.

The entrepreneurial model seems to be suitable because in a small operation, it is important to be efficient and effective so that limited resources can achieve maximum usage. Moreover, it is important for small NFP organisations to embrace continuous improvements and be innovative. Small NFP organisations can easily stagnate and be left behind if they do not become inventive in what or how they serve their community. A combination of the policy governance model with its strong strategic directions and the entrepreneurial model with its business-oriented goals will benefit small NFP organisations.

### **3.2.2 Corporate financial control and governance mechanisms in the FP sector**

#### **i) Purpose of studying FP corporate governance**

Financial governance is critical for good governance for a small NFP organisation because the consequences of failure can mean that the organisation becomes insolvent. It is important that directors develop their knowledge and skills in financial governance to strengthen the corporate governance of their organisation. Since there is little literature specifically for small NFP organisations, key areas in financial governance such as governance practices, financial risks, reporting responsibilities and other key financial considerations that exist in FP companies will first be discussed.

The literature in this section discusses the many codes and legislations that are available for FP companies, especially in the United Kingdom (UK) and the United States (US) (Addison-Hewitt Associates, 2003; Weidenfeld, 2004). As all the codes and legislations cannot be discussed individually in detail, only a select few will be discussed below.

The literature indicates that FP legislations such as the Sarbanes-Oxley Act (US) can be used to guide directors of NFP boards because their fiduciary duties are similar to the fiduciary duties of directors of FP boards (Weidenfeld, 2004). The literature also states that FP legislation can be used as a standard for NFP boards because, like FP companies, NFP organisations also have public responsibilities (Weidenfeld, 2004). For that

reason, FP legislation such as the Sarbanes-Oxley Act (US) may be used as a standard to develop 'best practice' for NFP organisations.

In view of the above, codes and legislations that are available for FP companies, especially in the United Kingdom (UK) and the United States (US), will be studied in greater detail in this section.

Over many years and in many countries, codes of conduct in the form of reports and legislation have been presented in an effort to protect shareholders' interests (Brennan & Solomon, 2008). In the UK, there has been the *Cadbury Report* in 1992, the *Combined Code* in 1998, the *Combined Code on Corporate Governance* in 2003 and 2006, the *Greenbury Report* in 1995 and the *Higgs Report* in 2003 (Brennan & Solomon, 2008).

In the US, there has been the Sarbanes-Oxley Act (Addison-Hewitt Associates, 2003; Alkhafaji, 2007; Weidenfeld, 2004) and in recent years the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Acharya, Cooley, Richardson, & Walter, 2011; Financial Regulatory Reform Working Group, 2010).

### **ii) The *Cadbury Report***

The *Cadbury Report*, which was conducted in the UK by the Committee on the Financial Aspects of Corporate Governance, was specific to Boards of Directors, the accountancy profession, and shareholders (Cadbury, 1993). This report is the Code of Best Practice for the Board of Directors, non-executive directors, executive directors, and the issue of reporting and controls (Cadbury, 1993). The *Cadbury Report* based its code on the need for adequate disclosure and appropriate checks and balances within the governance structure of companies.

The code is based on the principles that board structures and processes should aim to meet, rather than prescribe precisely, the nature of those structures and processes. This is to meet the diversity of board situations

and to guard as far as possible against form prevailing over substance in terms of compliance.

As mentioned in the introduction to this research, if the NFP sector is to implement financial management strategies, controls and governance mechanisms such as those used in the corporate world in order to protect its assets and finances, there is an assumption that the corporate world is in a strong financial position and much can be learnt from how it manages its finances.

The global financial crisis of 2008 seems to indicate that the way the corporate world operates does not always guarantee growth and financial sustainability. For that reason, it is important to mention the financial reform bill that was passed in the United States of America in 2010 to address some of the shortcomings in FP operations.

### **iii) The Dodd-Frank Wall Street Reform and Consumer Protection Act (US)**

In an effort to prevent another economic meltdown, on 21 July 2010, President Barack Obama of the United States of America (US) signed into law a package of financial regulatory reforms (Financial Regulatory Reform Working Group, 2010). This is because the 2008 economic crisis was believed to be the result of inadequate oversight and insufficient transparency. These reforms are believed to be unparalleled in scope and depth and consist of more than 2300 pages of text (Financial Regulatory Reform Working Group, 2010). The legislation which is called the Dodd-Frank Wall Street Reform and Consumer Protection Act, was the response to the reaction to the most severe financial crisis since the Great Depression (Financial Regulatory Reform Working Group, 2010).

The above legislation changed the regulatory structure of the US financial system considerably, with broad and deep implications for the financial services industry where the problems revolve around global business

transactions involving US-based corporations, assets and financial instruments (Financial Regulatory Reform Working Group, 2010).

The US Congress, in a large measure, delegated both the substantive details of the reforms and their implementation to federal regulators whose authority grew with the introduction of this new bill (Financial Regulatory Reform Working Group, 2010).

Increased government regulation was introduced for the protection of financial consumers (Reuters, 2010). A new bureau in the Federal Reserve was set up through the new bill to regulate mortgages and credit cards (Reuters, 2010). Along with the above, a new council of federal regulators monitor the entire financial sector, while high-risk firms are singled out for stricter policing (Reuters, 2010). Through this new bill, financial and market transparencies have increased, but not for non-financial companies (Financial Regulatory Reform Working Group, 2010).

The impact of this new bill was felt beyond the financial sector, as aspects of the legislation have the potential to affect all public companies. This was done by extending federal regulation of corporate governance, majority voting for directors, limits on executive compensation, and mandatory board risk committees for non-financial companies in the final legislation (Financial Regulatory Reform Working Group, 2010).

The above bill is a financial control measure taken by the President of the US to force the corporate world to be accountable so that another financial crisis can be prevented.

#### **iv) The Sarbanes-Oxley Act (US)**

Another bill that was introduced in the US as a financial control measure is the Sarbanes-Oxley Act. In July 2002, the Sarbanes-Oxley Act came into force introducing major changes to the regulation of financial practice and corporate governance (Addison-Hewitt Associates, 2003; Beneish, Billings &

Hodder, 2008). It also set a number of deadlines for compliance. This legislation took its name from the two main architects, Senator Paul Sarbanes and Representative Michael Oxley (Addison-Hewitt Associates, 2003). This legislation is organised into eleven titles, and the most important sections on compliance are considered to be 302, 401, 404, 409, 802 and 906 (Addison-Hewitt Associates, 2003).

In the study by Beneish et al. (2008), 330 firms in the US that were making unaudited disclosures required by Section 302 were researched, as were 383 firms making audited disclosures required by Section 404 of the Sarbanes-Oxley Act. The results showed that Section 302 disclosures showed abnormal returns of -1.8 percent, and that firms experienced an abnormal increase in equity cost of capital of 68 basis points. It was concluded by Beneish et al. (2008) that Section 302 disclosures are revealing and indicate a lower credibility of disclosing firms' financial reporting. In contrast, Beneish et al. (2008) found that Section 404 disclosures have no noticeable impact on stock prices or firms' cost of capital.

The research above demonstrates the importance of audited financial reports especially because Section 404 disclosures indicated that they have no noticeable impact on stock prices or firms' cost of capital. This means that the audited financials reflected the actual financial standing of the organisations.

According to Alkhafaji (2007), Section 302 of the Sarbanes-Oxley Act deals with new regulations that require accountability for the information provided. The Act states that all statutory financial reports are to include certification that:

- the signing officers have reviewed the report
- the report does not contain any material untrue statements or material omissions or be considered misleading

- the financial statements and related information fairly present the financial condition and the results in all material respects
- the signing officers are responsible for internal controls and have evaluated these internal controls within the previous ninety days and have reported on their findings
- a list is provided of all deficiencies in the internal controls and information on any fraud that involves employees who are involved with internal activities
- any significant changes in internal controls or related factors that could have a negative impact on the internal controls have been noted.

The Sarbanes-Oxley Act ensures that directors of FP companies put into place financial controls, have the skills to review them and are directly responsible for ensuring that the company's internal controls are working towards securing the business's financial strength. There seems to be no such control that requires accountability for the information provided in the NFP sector for small NFP organisations.

Strong financial controls help internal auditing. This allows the financial team to have confidence in the numbers being reported to management and help protect the organisation's assets. The implication of the Sarbanes-Oxley Act for NFP organisations is that there is a real need for a clear code of conduct.

There is an accounting standards body that has the responsibility for the development of accounting standards for application by NFP organisations, and this is discussed in greater detail below (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995). However, it does not have separate standards for small NFP organisations.

#### **v) The Australian Accounting Standards Board**

The body that establishes the accounting standards in Australia is the Australian Accounting Standards Board. It was established by Section 224 of the *Australian Securities Commission Act* and has responsibility for the development of accounting standards for application by companies, including

NFP organisations, and for the development of Statements of Accounting Concepts (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995; Smith, 2001). When issuing a Statement of Accounting Concepts, the board carries out one of its functions under Section 226 of that Act (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

The Australian Government uses NFP organisations to deliver services that it does not (Productivity Commission, 2010), and these organisations receive government funding for such services. According to the Public Sector Accounting Standards Board and Australian Accounting Standards Board (1995), contributions made to NFP entities by, for example, governments, donors, members and others, are non-reciprocal transfers in the way that these organisations are not required to return an approximate or commensurate value in exchange for the contributions made and the contributions are considered to be revenues unless they are of the nature of contributions by the owners.

The Public Sector Accounting Standards Board and Australian Accounting Standards Board (1995) state that contributions to NFP entities are not considered to be contributions by owners because the contributors do not expect to receive a financial return equal to the assets provided, nor do the donors obtain in return for the contributions a financial interest in the net assets of the entity that can be sold, transferred or redeemed. However, the donors will normally have a continuing interest in how the entity uses contributed assets and will often impose temporary or permanent restrictions on their use (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

Restrictions set by the contributor impose fiduciary responsibilities on managements and governing bodies to ensure that contributed assets are used by the entity for the purpose stipulated by the contributors (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995). One such restriction may be for a particular donated item not

to be sold by management or the governing body. The NFP organisation, however, is able to pool contributed assets and sell or exchange them for other suitable assets provided that the future economic benefits represented by the contributed assets are not deployed in a way contrary to the contributors' stipulations (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

According to the Public Sector Accounting Standards Board and Australian Accounting Standards Board (1995), if an asset is provided for the purpose of acquiring a building, once the building has been acquired the restriction on the asset ceases and the building would be regarded as an unrestricted asset. The second example given by the Public Sector Accounting Standards Board and Australian Accounting Standards Board (1995) is a situation where an asset is provided for the purpose of investing in securities, the revenues from which are to be used to award scholarships for overseas study. In this case, the restriction on the assets would be permanent.

The acceptance of contributions imposes a fiduciary responsibility on the management or governing body of a NFP entity to use the contributed assets efficiently and effectively in carrying out the aims of the organisation. This fiduciary responsibility includes all of the organisation's assets, not just assets that have contributor-imposed restrictions, and does not constitute a legal, equitable or constructive obligation. A NFP entity's fiduciary responsibility to use assets to provide goods and services to the public does not, of itself, create a duty or responsibility on the organisation to sacrifice economic benefits to particular external parties (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

In the case of FP organisations, in the assessment of their performance, revenues may be related to expenses incurred during the reporting period, and the net result may be evaluated by reference to the assets employed by the entity to achieve the result. In the case of NFPs, reporting of expenses enables users to assess the cost of goods and services provided by the entity during the reporting period, and reporting of revenues enables users to

assess the extent to which the cost of providing goods and services has been recovered by the organisation during the reporting period (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

If assets are provided to a NFP organisation on the condition that the entity is to make a transfer of equal economic benefits, and that reciprocal transfer has not occurred before the reporting date, the recipient entity will have a liability (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

In a financial report of a NFP organisation, a liability would arise in respect of contributions received by the organisation from donors, members, governments or others where the entity has failed to meet the specific conditions attached to a contribution, and the amount must be repaid (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995). In the above circumstance, the organisation has a present obligation to a creditor that has been created due to a past event that is the failure of the entity to meet the conditions for keeping the contribution. The financial requirements for an NFP organisation depend on the legal structure it takes on. Some legal structures are required to carry out financial audits as a control measure. This was discussed in detail in Chapter Two.

#### **vi) Financial audits**

Performing a financial audit is another control mechanism. In the UK, financial audit of companies became highly regulated in the late 1970s, with the forming of the Auditing Practices Committee in 1976 (Power, 1996). Financial regulations and charities are two fields where the need for financial audit has developed, and particular statutory initiatives have extended the role of audit (Power, 1996).

One of the issues of performing a financial audit is the cost involved, where some believe that the cost outweighs the benefits (Power, 1996). Power

(1996) says that financial audit is a policing mechanism without which there could be more fraud, deception, waste, error and poor administration. Power (1996) goes on to say that audits have become a necessity because of the need for accountability where distance, or other factors where the principal cannot directly verify the activities of the agent are involved. Financial audit is also a mechanism that imposes financial discipline. It allows organisations to be transparent to the communities they serve, hence evoking public trust.

The above corporate financial control and governance mechanisms are widely used in the FP sector and large NFP organisations. Large NFP organisations and large companies are regulated and monitored through their reporting requirements. As for small businesses, the owner also controls the business and will want to do everything possible in the best interests of the business. What is lacking in Australia is the monitoring of small NFP organisations. This situation is further exacerbated by the separation of ownership and control which was discussed in Chapter Two. This issue will be discussed in greater detail in agency theory below.

### **3.2.3 Corporate governance issues in the NFP sector**

#### **i) Agency theory**

Although the literature addresses issues related to the governance of NFP organisations, they have not been as thoroughly investigated as for commercial enterprises (Mordaunt & Cornforth, 2004; Turbide et al., 2008). Over the years, a lot of attention has been focused on good governance of listed companies to safeguard the integrity of these companies (Dalton & Dalton, 2006; OECD, 2004a; Weidenfeld, 2004).

In a FP organisation, managers manage the corporations while the shareholders who are the owners receive dividends. The shareholders do not take part in the business operations, and Boards of Directors are elected to oversee corporations on behalf of shareholders (Alkhafaji, 2007). Since the owners do not take part in everyday operations, there are standards and rules that listed company directors have to adhere to. These standards or

good governance are in place to safeguard the interest of the shareholders in the FP sector. The board then takes on legal responsibilities, becoming legally responsible for corporate actions and the impact these actions might have on society (Alkhafaji, 2007).

The quality of governance is not only related to skills, knowledge and experience, but also the make-up of the governing body. As mentioned above, although much emphasis has been placed on the governance of listed companies, other types of organisations, such as NFP organisations, can also benefit from having strong governance practices as well.

According to Turbide et al. (2008), for many scholars interested in NFP governance, one of the main differences between FP companies and NFP organisations is the difficulty in ascertaining the real owners of the NFP organisations. Some scholars say that NFPs do not have owners (Ott & Dicke, 2012). In the NFP sector, whether there are no owners or absent owners, agency theory is important in the discussion of corporate governance. As mentioned in the previous chapter, the separation between ownership and management was first discussed in the classic 1932 study of Berle and Means and supported by Lamer's 1971 study (Brennan & Solomon, 2008; Alkhafaji, 2007). This theory discusses the problems faced by NFP organisations because of the absence of owners in the management of the daily operation of the organisation.

Agency theory has become a big issue in the running of any business because agency literatures posit that employment contracts of executives may not perfectly align the interests of top managers and shareholders (Beatty & Zajac, 1994; Wright, Ferris, Hiller, & Kroll, 1995). Agency costs accrue when there is a gap between the alignment, as mentioned above (Desai et al., 2005). The separation between the management and the shareholders of a firm is the agency relationship (Desai et al., 2005). Resulting from the separation is the divergence between the agent's pursuit of self-serving strategies and those strategies that would enhance the

welfare of the principal (Jensen & Meckling, 1976; Wright, Kroll, Lado, & Van Ness, 2002).

This difference between managerial interests and owners' interests creates the necessity for the monitoring of managerial decisions (Desai et al., 2005). The role of Boards of Directors comes into play as they are authorised to monitor the CEO's decisions in order to protect the interests of shareholders (Desai et al., 2005). Besides the monitoring by ASIC, board monitoring is a second layer of protection for the owners in large companies.

Agency costs are inevitable within an organisation whenever the owners are not in charge of running the organisation (Shleifer & Vishny, 1997). A conflict of interest arising from differing goals between owners and management can raise agency costs. This money can be better spent on providing proper material incentives, such as performance bonuses, stock options and moral incentives for agents to properly execute their duties, thereby aligning the interests of the owners and agents (Shleifer & Vishny, 1997).

Much has been written about agency costs and problems in relation to agency costs in publicly traded companies (Bebchuk & Fried, 2003; Easterbrook, 1984). There is not much research on agency costs and problems arising from agency costs in NFPs. Besides agency theory, the literature has also shown other corporate governance issues faced by small NFP organisations. One may not be able to use corporate governance best practice that is available for the FP and public sectors because NFP organisations face different challenges (Considine et al., 2014).

### **ii) Lyon's six challenges in the NFP sector**

Lyons (2001) raised six distinguishing characteristics of the NFP sector and states that NFP organisations are value-laden. The values of these NFP organisations cannot be easily forgotten or set aside (Considine et al., 2014), resulting in their struggle to change in response to changes in the economic environment (Lyons, 2001).

The second challenge that NFP organisations face, according to Lyons (2001), is the fact that they have multiple sources of income, such as membership fees, donations, different grants that fund different programs, self-generated funds, etc. It can be time-consuming and difficult to manage these different streams of income. Contractual obligations for the different grants could also be different such as templates, reporting period, projects, etc. These differences can multiply work for a solitary CEO.

Some organisations rely solely on volunteers in their organisations while other organisations rely on both volunteers and paid staff. Most NFP organisations rely to some extent on volunteers (Lyons, 2001). According to Lyons (2001), the third challenge that NFP organisations face is to determine the most effective combination of volunteers and paid staff, which is not an easy task.

The fourth challenge is in determining the organisation's performance (Lyons, 2001). Lyons (2001) provides childcare as an example of an industry that is difficult to judge because there is no relevant data for the purpose of performance evaluation. The example that Lyons provided may not be a good one because performance by a childcare provider could be determined in a myriad of ways. The number of hours the service is open could be used as a performance measure, as some childcare services may provide after hours, weekend or even overnight services. Another performance measure is the number of children who use the service or the cumulative hours that all the children are in their care. Income can also be used to measure a childcare service's performance.

According to Smith (2001), there is a fundamental distinction between performance measures in a FP company and a NFP organisation. The difference is that in a FP company, the measure could be the return on investment, while in the NFP sector the focal point could be the flexibility of the use of resources (Smith, 2001).

The fifth characteristic is that there are multiple stakeholders of a NFP organisation. This includes owners (members), funding bodies, clients, staff, partner organisations, governments, consultants, suppliers, researchers, customers, professional bodies and the general public (Lyons, 2001).

The final characteristic of a NFP organisation is the tension between senior staff and the board or management committee (Lyons, 2001). The result of this tension between the CEO and the board can be due to the interference of directors in management matters as such interference can undermine the role of the CEO. According to Lyons (2001), these tensions arise from a lack of clarity about the role of the board and management.

### **iii) NFP Board of Directors**

According to Glaeser (2003), NFP boards continue from term to term, are hardly ever subject to elections and never to takeovers. This may occur if an organisation has limited members who all make up the board but if membership is larger than the number of positions on the board, an election will need to take place. As mentioned in Chapter Two, NSW Fair Trading requires that NFP organisations hold an AGM where board members are elected by the members.

NFP Board of Directors cannot sell or transfer their power because they do not own an asset that is directly linked to the success of the organisation (Glaeser, 2003). In a NFP organisation, there seems to be no law requiring Boards of Directors to act as good stewards of past investment by a donor (Glaeser, 2003).

A FP manager's salary can be fixed to his firm's stock price but no comparable standard exists for most NFP organisations (Glaeser, 2003). Glaeser (2003) goes on to state that the CEO and the board have virtually an unparalleled degree of control in a NFP organisation. The basic principles of good governance are vital to the success of all organisations, such as having a board charter, well defined roles and responsibilities for board members,

relevant financial knowledge, accountability and transparency to members, shareholders and stakeholders.

It is common knowledge that there is a very stringent process in choosing board members in a FP organisation compared to a NFP organisation. In many cases, potential board members need to fill out an application form stating their skills and experiences. This may not be the case in the NFP sector. In the past and perhaps in some cases in the present, the boards of NFP organisations have not been thought of as operating at the same level of performance as in the commercial sector (Ralph, 2007). However, this perception is beginning to change. In the last ten years, research has begun to focus on issues related to the governance of NFP organisations (Turbide et al., 2008), but it has not been investigated in an in-depth manner as for commercial enterprises (Mordaunt & Cornforth, 2004).

According to Ralph (2007), the common perception of NFP boards are of inefficient meetings, a place for socialites and retired business people to exercise self-importance, a pastime for some and an environment where it is all right to be 'soft'. It is not uncommon today for potential and hopeful company directors to acquire their first board experience in the NFP sector, implying that an NFP organisation is the place to learn board skills before moving on to paying or 'real' boards (Ralph, 2007).

Such attitudes belittle the complex and difficult role that NFP board members have and the diverse skills they are required to possess to make such organisations successful. Governing and operating a NFP organisation can be extremely onerous. Factors such as the constant revolving door of short-term volunteers, complexity in defining goals, the ongoing 'survival' mode they operate in, the diversity of stakeholder groups, the complicated funding arrangements, and the frequent lack of resources make NFP organisations some of the most difficult and challenging to govern effectively.

When discussing governance of NFP organisations, one cannot ignore the fact that there are many NFP organisations built on Crown Land which has its own rules on governance.

#### **iv) When a NFP organisation is also a reserve trust**

In Australia, a reserve trust is a corporation established under the *Crown Lands Act 1989* to manage a Crown reserve (Land and Property Management Authority, 2010). Trusts can be managed by:

- corporate managers of either a community or local organisation, or a local government council, or the Ministerial Corporation
- a community Trust Board
- an administrator when special skills are required. (Land and Property Management Authority, 2010)

It is important to note that when a board of an NFP organisation is also the Trust Board, a consolidation or demarcation of board responsibilities is clearly set out in the organisation's constitution because a reserve trust enjoys a level of autonomy in its care, control and management of the Crown reserve. This includes entering into maintenance contracts, determining the development of the land (subject to Crown consent), setting entry fees, and employing people to work for it (Land and Property Management Authority, 2010). A Trust Board must have three to seven members (Land and Property Management Authority, 2010). The restriction of having only three to seven members on a board will be discussed further in the next chapter. Each member on a board have fiduciary responsibilities.

#### **v) Fiduciary responsibilities**

This section discusses Board of Directors' fiduciary responsibilities. The term 'fiduciary' has been around for centuries, and the early literature is still being used when discussing the term. This section presents information on how the term was first used. Since it includes historical information, some of the references are old but the information is still valid.

According to Twaits (1998) a major inhibitor of responsible corporate governance principles being applied in the NFP sector is the vast differences in the size and resources of the organisations. By this he means that it would be much easier to implement responsible corporate governance procedures in large NFP organisations that have a big budget than in a small NFP organisation with only enough resources to make ends meet. Having sufficient funds to contract specialists in legal and financial matters allows directors to properly discharge their statutory and fiduciary obligations to the organisation.

Trustees have been required by courts to act in the best interests of beneficiaries in the same manner that they would their own interests (Easterbrook & Fischel, 1993; Scott, 1949), irrespective of whether the beneficiary and agent have a contract or if the task is gratuitous (Scott, 1949). Courts have been applying the duty of loyalty and its remedy to other agency relations under the term 'fiduciary' duty for the last two centuries (Easterbrook & Fischel, 1993).

There are many types of fiduciaries, including agents, partners, directors and officers, trustees, executors and administrators, receivers, bailees and guardians (Frankel, 1983). According to Frankel (1983), trustees, administrators and bailees can be considered to be original fiduciaries, before agents appeared at the end of the eighteenth century. In the commercial world, the fiduciary duties of partners, corporate directors and officers came about with the formation of partnerships and corporations (Frankel, 1983).

Directors of NFP organisations have a fiduciary responsibility to act in the best interests of the organisation. Smaller organisations with limited funds rely on their elected directors to provide advice on all matters, including legal and financial issues, even though they may have limited knowledge on these matters. Weidenfeld (2004) states that board members must be aware of their duties as directors, not only to fulfill their fiduciary responsibilities, but also to avoid personal liability.

As mentioned above, governance is becoming a more significant matter generally in all sectors, including the NFP sector (Turbide et al., 2008). When the issue of governance is discussed it is important to discuss board composition and individual board members' skills. The focus on choosing directors for any organisation is skills, knowledge and experience. In some small NFP organisations a member's standing in the community may also play a role in the members' reason for choosing a particular director. Whatever the reason may be for selecting a director, one of the main things that he or she must understand is his or her fiduciary responsibilities. They have a duty to act in the best interests of the organisation, and their fiduciary responsibilities are closely linked to business ethics.

#### **vi) Business ethics**

With the discussion of corporate governance, it is inevitable to include the topic of ethics. According to Machan and Uyl (1987), two influential journals in the area of business ethics began in the early 1980s: The *Journal of Business Ethics* started in 1980, and the *Business and Professional Ethics Journal* started in 1981.

Brower and Shrader (2000) examined differences in moral reasoning and ethical climate between board members in the FP and NFP sectors. They studied six FP and seven NFP corporations and found that the two types of boards did not differ in moral reasoning but exhibited different types of ethical climate (Brower & Shrader, 2000). FP companies had climates higher in egoism than did NFP organisations, while NFP firms reflected higher benevolence factors than FP firms.

Brower and Shrader (2000) state that in a NFP environment, which does not have a money-making motive and there is no need to be accountable to shareholders, directors are able to more easily act in the best interests of all stakeholders. This impression stems from the fact that NFP directors volunteer their time to sit on the board of their choice and, because there is

no financial remuneration, the motivation for their service may be somewhat more selfless in nature (Brower & Shrader, 2000).

The above theory was supported by Machan and Uyl (1987) when they found that directors of NFP boards working in a charitable environment are more ethically minded than corporate FP board members (Machan & Uyl, 1987). According to Glaeser (2003), widespread looting of endowments is almost unheard of in the NFP sector.

Although the above may be a resounding support for NFP Board of Directors, one must remember that directors of NFP organisations are only human and, although they may be very ethical, they may unintentionally make mistakes. For that reason, it is always good to have checks and balances.

#### **vii) Lack of checks and balances**

Glaeser (2003) claims that due to the differences between FP companies and NFP organisations, the CEO and the Boards of Directors in NFP organisations have an almost unmatched degree of autonomy. He states that donors do recognise that they have little influence on the institutions that they endow and are aware that the only effects of their gifts will be to increase the budget of the recipient NFP (Glaeser, 2003). This is not completely correct as donors can stipulate conditions on their donations. This was discussed in the section about the Australian Accounting Standards Board. If a NFP organisation fails to meet the conditions attached to a contribution, the amount must be repaid (Public Sector Accounting Standards Board & Australian Accounting Standards Board, 1995).

Unlike the NFP sector, the public sector in New South Wales has a body that protects the public interest and prevents breaches of public trust while guiding the conduct of NSW public officials. This body, the Independent Commission Against Corruption (ICAC) was established by the NSW Government in 1989 in response to growing community concern about the

integrity of public administration in NSW (Independent Commission Against Corruption (ICAC), 2012).

ICAC's full jurisdiction and functions are set out in the *Independent Commission Against Corruption Act 1988* but, briefly, their role is to investigate and expose corrupt conduct in the NSW public sector, to actively prevent corruption through advice and assistance, and to educate the NSW community and public sector about corruption and its effects (ICAC, 2012).

Besides the NSW Police Force, ICAC's jurisdiction extends to all NSW public sector agencies and employees, including government departments, local councils, members of parliament, ministers, the judiciary and the governor and includes those performing public official functions (ICAC, 2012).

Large NFP organisations have a system of checks and balances in place. This was mentioned in Chapter Two, where it was explained that NSW Fair Trading requires audited financial statements to be presented to an organisation's members at its Annual General Meeting, and these audited financial statements are to be submitted to NSW Fair Trading (Department of Fair Trading, 2010). This is also the case for medium and large NFP organisations registered with ASIC (ASIC, 2010c). These financial statements are not only scrutinised by the organisation's members, but also the administering body.

In larger NFP organisations, boards are becoming more aware of board responsibilities (Turbide et al., 2008) and provide training for directors or elect directors with relevant experience. Directors may also be sent for corporate governance or company director training. This is because people are becoming more aware of the direct link between governance and the success of a NFP organisation.

As mentioned in Chapter Two, large companies and NFP organisations have more stringent reporting requirements and greater levels of accountability to their stakeholders. This type of checks and balances built into the system

does not exist for small NFP organisations. As mentioned in Chapter Two, Tier 2 organisations are not required by NSW Fair Trading to submit an audited report to their membership or to NSW Fair Trading. This is also the case with small NFP organisations that are registered with ASIC. All they are required to do is to present a summary of their financial affairs at the AGM and submit a summary of their financial affairs to NSW Fair Trading. This summary is internally prepared and does not go through the same level of robust financial scrutiny that an audit process provides.

One of the reasons that Tier 2 organisations have limited reporting requirement could be because of the element of risk. Due to the fact that Tier 2 organisations have a turnover of less than \$200,000, the risk involved is relatively low compared to large NFP organisations.

It is important that the directors of NFP organisations realise the potential legal exposure they face, which are similar legal liabilities as company directors, even though many of them may be volunteers. For that reason, directors of NFP boards should pay close attention to the importance of having properly documented procedures, policies and record keeping in place to defend any actions against the organisation, having an appropriate method of communicating with stakeholders and donors to ensure accountability, having relevant insurances in place, and undertaking corporate governance training (Australian Institute of Company Directors, 2007).

Larger NFP organisations may be able to purchase appropriate insurances to indemnify their directors against potential legal actions. This is not always possible for smaller NFP organisations with limited resources. This creates a problem because not only could the directors not be aware that they are legally liable for the advice they give and for the decisions that the board takes collectively, but also any legal actions against them may have a strong negative impact on their personal finances.

All boards are responsible for indicating what financial information they need and for ensuring that they get this from management in an understandable form. It may be difficult for an untrained board to understand the financial health of the organisation, so it may be better for the board to have predetermined criteria indicating the financial health of the organisation. NFP organisation directors should be trained to understand profit and loss statements and balance sheets because they are liable if the organisation is found guilty of trading whilst insolvent (Australian Institute of Company Directors, 2007).

All NFP organisations are expected to have their own strategic directions. Since the focus of NFP organisations is not to make a profit but to provide a service to society, their directions should clearly indicate their social objectives. Due to the fact that some small NFP organisations may not have highly skilled or trained directors, they may struggle to define their purpose and direction. Organisations with unclear objectives can operate directionless, creating many major problems such as poor use of resources, missed opportunities, bad management and loss of confidence. These are real-life potential problems that impede on the progress of a NFP organisation and eventually bring the organisation down.

Due to the low financial risk involved, mainly due to lack of resources and limited assets, boards of small NFPs are also the least monitored or scrutinised. This issue is connected to the issues of trust and accountability discussed in the next section.

#### **viii) Trust and accountability**

Small NFP organisations in Australia, whether they are registered under NSW Fair Trading or through ASIC, are not required to carry out an audit. Therefore, as mentioned by Power (1996) earlier, the principal or, in this case the members, are unable to authenticate the accuracy of the agent's financial summaries. This affects the transparency of small NFP organisations and, in turn, affects the trust placed in them by the public.

Extant research conceptualises the concept of trust as a behavioural tendency that remains constant across different situations, thereby defining it as a characteristic of the trustor (Galloway-Gilliam et al., 2012). Empirical studies take a different perspective, stating that whether people trust or distrust others is attributable to the trustor's personality trait (Sorrentino, Holmes, Hanna, & Sharp, 1995).

Other studies show people's past experiences create a 'trust' or 'distrust' factor in others they interact with (Rotter, 1967). Rotter (1967) referred to this as a 'generalized expectancy', which is a belief as to what can generally be expected of others based on the trustor's history of positive or negative experiences.

The issue of trust is related to giving to NFP organisations. The literature suggests that there are a number of reasons why firms become donors to NFP organisations. The reasons include enhancing the corporate image (Polonsky & Macdonald, 2000), tax concessions (Allen Jr, 1999; Foran & Theisen, 2000), trust (Sargeant & Stephenson, 1997), the CEO's interest in the mission of the NFP (Werbel & Carter, 2002) and having control over how the firm's donation is spent (Kistner, 2000). It was found that trust in the NFP organisation was the main factor associated with motivation and the intention to continue donating (Sargeant & Stephenson, 1997).

Trust in a NFP organisation's operation grows over time. The effectiveness with which a board discharges its responsibilities and the manner in which management carries out its duties creates trust from the community in which it serves. It is important to have a good understanding of the conditions giving rise to trust in the NFP sector, although there are only a few studies that have investigated the antecedent conditions leading to trust among participants in NFP organisations (Galloway-Gilliam et al., 2012).

Trust yields voluntary co-operation (Hosmer, 1995), and this trust makes the trusting person willing to co-operate in spite of perceived risks (Johnson-George & Swap, 1982; Kee & Knox, 1970). According to Galloway-Gilliam et

al., (2012), the basis of this voluntary choice lies not in the ability to monitor or control others, but in one's confidence in another's goodwill. This is the type of trust that NFP organisations need from the community and the public at large.

Improving NFP accountability is an issue that has garnered much attention globally (Shamima, 2005) because this sector has grown in scope, size and assets (Bies, 2010; Shamima, 2005). As a result, there has been greater scrutiny over their operations and performance with their growth. Sponsors, donors, governments, community and clients have shown increased interest in them and are driving them to strengthen existing self-regulations (Bies, 2002, 2010; Ebrahim, 2003; Edwards & Hulme, 1996; Lewis & Opoku-Mensah, 2007; Sloan, 2009).

The literature indicates that it is now becoming more and more obvious that public trust in NFPs is not anymore 'a given'. Accountability is becoming a major issue in the NFP sector. The review of literature shows that some of this activity is driven by a universal expectation of accountability, which includes the need for financial transparency and increased board governance, which would result in a demonstration of sectoral legitimacy (Harrow, 2006; Svitkova & Ortmann, 2006). This shows the need for good governance for small NFP organisations.

#### **ix) Need for good governance**

The publication by the National Hub of Expertise in Governance of a code for organisations within the NFP sector was meant to change the state of affairs. Dawson and Dunn's 2006 article examined the appropriateness of the new code as a tool for regulation of the NFP sector and concentrated on the challenges facing codes of practice for NFP organisations, such as organisational vision and the purposes that such codes have in the NFP sector. The article concluded that although the new code added value to the sector as a governance and regulatory tool, there were significant aspects of the code that remained unclear, especially in the extent of the code's

constituency and the balance to be struck on the issue of compliance (Dawson & Dunn, 2006).

What Dawson and Dunn (2006) fail to raise is the fact that the code combines small and large NFP organisations together and treat them as if there is no differentiation in their operation and practice. There needs to be best practice and a code of conduct that addresses real governance issues faced specifically by small NFP organisations in Australia. Financial governance within the context of corporate governance must first be discussed before best practice can be designed and a code of conduct drawn out.

### **3.3 Gaps in the literature**

#### **3.3.1 Structural size of an organisation**

This section proves the need for this study through the demonstration of a lack of research for small NFP organisations. In addition to the lack of literature is the lack of monitoring, reporting and overall support for small NFP organisations, which are treated as if they are insignificant.

Small NFP organisations are disadvantaged in many ways. They have limited resources, whether they are financial, human, knowledge or governmental support. The influence of structural size as a precondition to the development of organisational commitment has been forefront in theoretical propositions about employees in work organisations (Meyer & Allen, 1991; Mowday, Porter, & Steers, 1982). Voluntary associations with larger budgets had more highly committed volunteers (Knoke, 1981).

In an article by Meyer and Allen (1991) they go beyond the existing distinction between attitudinal and behavioural commitment and argue that commitment, as a psychological state, has at least three separable components reflecting (a) a desire, which is considered to be an affective commitment, (b) a need, meaning a continuance commitment, and (c) an obligation, which is normative commitment to maintain employment in an organisation. Each component is considered to develop as a function of

different antecedents and to have different implications for on-the-job behaviour (Meyer & Allen, 1991).

Although size is an important precondition to the development of organisational commitment, most studies combine NFP organisations together and carry out research as if they do not differ in their operation. This study overcomes this problem by concentrating the research on only small NFP organisations in Australia with a turnover of less than \$250 000.

One development that emerged in 2005 that seemed to concentrate on small NFP organisations is a network of individuals and organisations called SONG, which stands for “small organisations non-government” (Suhood et al., 2006), which will be discussed in the section below.

### **3.3.2 SONG: small organisations non-government**

SONG came about after Tirrania Suhood and Mary Waterford prepared a paper for a roundtable discussion for small community organisations in NSW in July 2005 in collaboration with different individuals from different community organisations (Suhood et al., 2006). Voice for SONG NSW, a network of individuals and organisations, particularly small community organisations, was formed after the roundtable discussions (Suhood et al., 2006). The Council of Social Services of NSW (NCOSS) agreed to provide the secretariat for the group (Suhood et al., 2006). The paper was revised and released with the title, *The way forward: Tackling the issues confronting small community organisations*, for sector distribution and discussion in March 2006 (Suhood et al., 2006).

Although the name SONG indicates that it is a network of individuals and organisations in small community organisations, a review of the literature indicated that the small NFP organisations represented were not small as defined by the NSW Fair Trading or ASIC. Small NFP organisations are defined as organisations with a turnover of less than \$250 000 by both the NSW and Commonwealth regulators (ASIC, 2010b; Department of Fair

Trading, 2010). According to Suhood et al. (2006, p. 9), the small NFP organisations represented by SONG are:

- some have incomes as small as under \$50 000 per annum to some receiving up to one million dollars
- some have a sole worker, while others have between twenty and thirty workers
- there are a sizeable number of middle sized organisations in our sector.

Although SONG stands for “small organisations non-government” (Suhood et al., 2006), the organisations it represents are made up of small, medium and large NFP organisations as defined by ASIC. The definition of a small NFP organisation is set by both state and federal administering bodies as indicated in Figure 2.1 in Chapter Two. The term SONG is also misleading and is not the voice for small NFP organisations as it seems to imply.

### **3.3.3 Self-regulation for small NFP organisations**

Since small NFP organisations have a budget of less than \$250 000, they may not have the funds to strengthen their corporate governance through audits or systems that may be expensive. For that reason this section will investigate self-regulating mechanisms that already exist.

In much of Europe, self-regulation activity builds on long-established self-regulation systems (Guet, 2002). There has been the emergence of self-regulation in long-established and developing NFP organisations in Europe (Bies, 2010). Bies (2010) applied agency, resource dependence and institutional theories to specific national cases, which revealed three predominant self-regulated types of model: compliance, adaptive, and professional models conditioned on varied market, political and social antecedents.

The first model is the compliance system, which predominates in Western European cases such as in Germany, Switzerland, the Netherlands and

Austria, where the NFP sector is established with minimal regulation (Bies, 2010). *Compliance-oriented* self-regulation models are adopted when a NFP organisation must conform to a set of behaviours forced on them by external parties, such as “third-party evaluation or accreditation entities” (Bies, 2010, p. 1059).

The second self-regulated type of model, the adaptive model, is evidenced in the United Kingdom, where the NFP sector is well established but the self-regulated design shifts in response to changes in public regulation and the resource environment (Bies, 2010). *Adaptive* self-regulation models that are controlled by market mechanisms to moderate accountability behaviour (Bies, 2010).

Lastly, when the NFP sector and its legal system are both in the development stage, such as in Poland, the professional model of self-regulation occurs where the self-regulation emerges to shape philanthropic, civil society and NFP practice (Bies, 2010). *Professional* self-regulation models are designed to endorse industry practice, values and regulations, and to improve perceptions of NFP sector legitimacy (Bies, 2010).

It is estimated that NFP self-regulation systems are used globally in about 40 countries (Naidoo, 2004). Likewise, there has been an increase in modified self-regulation models in a number of European countries as the demand for accountability rises (Bekkers, 2003; Hayes, 1996).

Australian small NFP organisations may be able to self-regulate if they are given tools such as a corporate governance model of best practice and a code of conduct for directors that has been specifically developed for them. In Australia, the self-regulated model that can be adopted is the *compliance-oriented* model. Administering bodies such as NSW Fair Trading or ASIC can make it mandatory for small NFP organisations to comply.

### **3.4 Justification and hypotheses for this study**

In Australia, the NFP sector is divided into different categories based on their size. As mentioned in the previous chapter, the NSW state classifies NFP organisations as either Tier 1 or Tier 2, while the federal government classification is small, medium or large. The literature for this sector does not reflect this classification. Most, if not all, research for the NFP sector discusses a myriad of NFP issues such as corporate governance, financial management, CEO remuneration, etc. as if the sector is made up of organisations that are of one size.

Large and small NFP organisations operate very differently. To date, there are very few studies that focus on small NFP organisations. Small NFP organisations face different challenges than large NFPs. The literature for this sector has not caught up on the particular issues faced by small NFP organisations and this creates a gap in literature for this particular sector.

Secondly, there are no corporate governance models of best practice or codes of conduct for the directors of small NFP organisations in Australia. As mentioned in the previous chapter and in the introduction of this chapter, there are many studies conducted on financial controls and governance mechanisms for large and small commercial enterprises and for NFP organisations as a whole. Although there are many studies done on NFP organisations, they are not specific to their size. Small NFP organisations do not have corporate governance models of best practice or codes of conduct for the directors and this is the gap in the literature.

Thirdly, in Australia, large companies and large NFP organisations are closely monitored by either ASIC (ASIC, 2010c) or state authorities like NSW Fair Trading (Department of Fair Trading, 2010). Small NFP organisations are not monitored or required to provide an audited report to their administering bodies, and their financial records can be internally produced. This lack of monitoring, add to the fact that they are not controlled by the owners, may create problems. These potential problems include

mismanagement of funds, the risk of the board disregarding their fiduciary responsibilities and the attraction of giving themselves attractive benefits. Instead of serving its members by making decisions based on good business resolutions, the board and management can channel funds to pet projects and unnecessary perks.

Increasing regulations for this sector may be costly, especially since many of the small NFP organisations are not economically active, are run by volunteers and exist to serve a very small section of their community. Even though this may be the case, all organisations, irrespective of whether they serve a small or large section of the community, must have good governance.

There is a distinct gap in the literature for small NFP organisations in Australia. This research will propose a corporate governance model of best practice and code of conduct for small NFP organisations in Australia.

For the purpose of this research, a small NFP organisation is defined to be a Tier 2 NFP organisation with gross receipts of under \$250 000. The researcher will not be considering body corporate, such as for strata titles, and small unincorporated organisations. This research will only cover NFPs that are considered by the Australian Bureau of Statistics to have an active tax role and that employ staff or access tax concessions.

The literature review also reveals that in FP corporate governance studies, financial governance is part of corporate governance in legislation, practice or studies (Alkhafaji, 2007; Weidenfeld, 2004). This can be seen in the *Cadbury Report* (Cadbury, 1993) in the UK or the Dodd-Frank Wall Street Reform (Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010; Financial Regulatory Reform Working Group, 2010) and the Sarbanes-Oxley Act in the US (Addison-Hewitt Associates, 2003; Alkhafaji, 2007; Beneish et al., 2007), where many financial management regulations have been introduced. This, however, is not the case for NFP studies. Many of the corporate governance studies are on board and management performance

and responsibilities only, omitting the financial part of corporate governance (Australian Institute of Company Directors, 2007; Boyce, et al., 2007; Brower & Shrader, 2000; Glaeser, 2003; Machan & Uyl, 1987; Marx & Davis, 2012a; Ralph, 2007).

This study will look at corporate governance as board matters, and will discuss financial management separately, as financial governance. By doing so, it will ensure that the financial management part of corporate governance is not excluded. This research will have a strong focus on financial governance because without good financial governance, a small NFP organisation with under \$250 000 income can gradually overspend or underperform in generating income. Either of these actions can result in an organisation closing down due to a depletion of its funds.

For that reason, this research will need to investigate if good financial management practices have an impact on corporate and financial governance of a small NFP organisation. The conscientious building up of an organisation's cash reserve for an emergency could be considered a good financial management practice. Another area that can be investigated is the situation of an organisation being on the verge of closing down and if it has any association with its financial governance practices. This leads to the hypotheses.

The hypotheses for this research are:

H1: Cash built up in an organisation has an impact on the statements related to corporate governance.

H2: The organisation on the verge of closing down has an impact on the statements related to financial governance.

### **3.5 Research questions**

During the course of this study, four research questions emerged for the study of best practice in small NFP organisations in Australia. The research questions are as below.

**Question one:**

What are the significant corporate governance issues that exist in small NFP organisations in Australia?

**Question two:**

Are there appropriate 'best practices' that can be included to develop a corporate governance model of best practice specifically for small NFP organisations in Australia?

**Question three:**

Are small NFP organisations in Australia in a precarious state of survival and extinction?

**Question four:**

Will a model code of conduct strengthen the governance of small NFP organisations in Australia?

### **3.6 Conclusion**

This chapter establishes that there is a correlation between the effectiveness of a Board of Directors to the effectiveness of an organisation (Bradshaw et al., 1998). The literature also establishes that the Board of Directors is responsible for the corporate governance of any organisation (Aguilera, 2005; Considine et al., 2014).

Therefore, if the sustainability of any organisation is to be discussed, one has to examine the corporate governance of that organisation. In this study, the focus is on corporate governance of small NFPs. Although large and small NFP organisations are often studied collectively in the literature (Boyce, et al., 2007; Cain, 2008; Marx & Davis, 2012a), they are very different. Small NFP organisations do not employ many or any staff members, depend heavily on volunteers and work very differently to large NFP organisations. Due to their differences, small NFP organisations will need a different set of

best practice recommendations and codes of conduct for their directors. Since there are no studies specifically geared for small NFP organisations in Australia, this study will lead the way.

As discussed in this chapter, not all the models of NFP corporate governance are appropriate for small NFP organisations (Bradshaw et al., 1998). This is also the case for challenges that NFP organisations face. Some of the challenges mentioned by Lyons (2001) are not faced by small NFP organisations. For all these reasons, a separate study of only small NFP organisations is necessary.

Since there is not much monitoring of small NFP organisations in Australia through state or federal agencies, it may be more feasible to provide these organisations with tools to self-regulate. There has been the emergence of self-regulation in long-established and developing NFP organisations in other parts of the world, such as in Europe. Self-regulated tools will also help avoid excessive costs for small NFP organisations that already have limited resources, and introducing self-regulating instruments to assist them with good governance is being suggested in this research. Self-regulation will not only assist to strengthen governance but empowers the organisation to take greater responsibility for their organisation.

Australian small NFP organisations can self-regulate if they are given tools such as a model of best practice and a code of conduct for directors that has been specifically developed for them. This is because small NFP organisations operate differently and face different challenges than large NFPs. Thus, it is vital to investigate small NFP organisations separately to large NFP organisations.

## Chapter 4: Theoretical Framework

### 4.1 Introduction

Chapter four is the first line of enquiry that establishes the theoretical framework for this research. The previous chapter found that there is a lack of literature available for small NFP organisations. It also established that there is no literature on corporate governance models of best practice for small NFP organisations. Through the literature review, a gap was established and a few research questions emerged.

The research questions are:

**Q1:** What are the significant corporate governance issues that exist in small NFP organisations in Australia?

**Q2:** Are there appropriate 'best practices' that can be included to develop a corporate governance model of best practice specifically for small NFP organisations in Australia?

**Q3:** Are small NFP organisations in Australia in a precarious state of survival and extinction?

**Q4:** Will a model code of conduct strengthen the governance of small NFP organisations in Australia?

It was then necessary to determine how this gap will be investigated and the research questions answered. This will be done by creating a theoretical framework which is a study on available 'best practice'.

Section 4.2 will continue with the discussion on best practice principles and the lack for them for small NFP organisations. It further introduces the six significant 'best practice' studies that will be used to create the research framework.

Section 4.3 proceeds to list the best practice principles in each of the six significant studies. These six studies were chosen because they are 'best

practice' studies that focus on corporate governance. The 'best practice' principles extracted from the six studies are listed in Table 4.1 below.

In Section 4.4, the best practice principles are evaluated to determine if they are appropriate for small NFP organisations. Those that are appropriate will be adopted into a literature-informed proposed model of best practice for small NFP organisations and those that are unsuitable will be discarded.

As stated above, the review of literature in this chapter is the first line of enquiry which formulates the research framework.

#### **4.2 'Best practice' literature**

This section reviews the findings from Chapters Two and Three. It has been established that there does not seem to be any corporate governance 'best practice' literature available for small NFP organisations in Australia or overseas. For that reason, best practice recommendations from other structures will be used to develop a model for small NFP organisations. What seems to be abundantly available is best practice documents for a 'one size fits all' type of NFP organisation research (Boyce, et al., 2007; Cain, 2008; Marx & Davis, 2012a) and FP companies (Dalton & Dalton, 2006; OECD, 2004; Weidenfeld, 2004).

There are several reasons why a best practice model is needed for small NFP organisations. Firstly, small NFP organisations have limited governance instruments to protect the interests of the organisation or its membership. Most Boards of Directors of small NFP organisations are volunteers who work by themselves or with a CEO (Suhood, 2001).

Secondly, there is also limited monitoring of small NFP organisations. Figure 2.3 in Chapter Two illustrates this problem. Small NFP organisations are only required to submit a summary of their financial affairs at the AGM and a summary of their financial affairs to state authorities like NSW Fair Trading (Department of Fair Trading, 2010).

Thirdly, there is also low accountability in this sector. This issue is illustrated in Figure 2.4 in Chapter Two. There is a clear separation of ownership and control in small NFP organisations. If the members can be identified as the owners, while management and directors have control of the organisation, this separation of ownership and control may not result in decisions made in the best interests of the organisation.

Due to the fact that there is limited governance, low monitoring and little accountability in small NFP organisations in Australia, there is a vital need for a model of best practice for corporate governance and a code of conduct for directors of these organisations.

There are higher standards of governance available for other sectors, especially the FP sector, which can be used to draw out a model of 'best practice' for small NFP organisations. These instruments can be used to strengthen governance in small NFP organisations in Australia.

Moreover, there is increased commercialisation in the NFP sector, making the organisations resemble FP firms (Shamima, 2005). The type of commercialization occurring in NFP organisations include forming business partnership with FP firms, creating a business arm of the NFP organisation and becoming more reliant on a fee-for-service type of operation (Hammack & Young, 1993; Salamon, 1996; Weisbrod, 1997). Therefore, it would be appropriate to use current FP 'best practices' to develop a model of best practice for small NFP organisations.

A few significant studies in NFP organisations and FP companies will be investigated to draw out their 'best practice' recommendations for corporate governance. They are, *The board member perspective on best practice in nonprofit governance* (Marx & Davis, 2012a), *Best practice in nonprofit governance: dealing with voluntary reforms* (Boyce et al., 2007), *Commentary: good governance, best practice for nonprofits* (Cain, 2008), *Sarbanes-Oxley and fiduciary best practice for officers and directors of nonprofit organisations* (Weidenfeld, 2004), *OECD principles of corporate*

*governance* (OECD, 2004) and *Corporate governance best practices: the proof is in the process* (Dalton & Dalton, 2006).

Marx and Davis (2012a) say that governance of private NFP organisations requires an advanced level of skills on the part of management and their directors. However, due to the voluntary nature of these board positions, they are filled by people who wish to 'do good' but do not possess the relevant skills. They go on to say that people serving as volunteers on NFP boards need the guidance that a research on 'best practice' could provide.

Although Marx and Davis' (2012a) study of 193 NFP board members seeks to clarify the board perspective on best practice in NFP governance, they focus their study on whether the governance structure of NFP organisations resembles that of the policy governance model. Weidenfeld (2004), in his article entitled *Sarbanes-Oxley and fiduciary best practices for officers and directors of nonprofit organisations*, states that NFP fiduciary duties parallel the obligations imposed on officers and directors of public corporations. He goes on to say that while the Sarbanes-Oxley Act (US) does not extend to NFP organisations, it may set the standards by which corporate governance for all organisations that have public responsibilities, including NFP organisations, are judged (Weidenfeld, 2004).

Whilst Weidenfeld (2004) used the Sarbanes-Oxley Act (US) to extract recommendations that could be used by NFP directors for good governance, Boyce et al. (2007) used the US Internal Revenue Service (IRS)'s standards for their 'best practices' recommendations for NFP organisations in the US. The IRS standards were released 2 February 2007.

Although the IRS does not have the power to control NFP governance, it did call on the NFP sector to implement 'best practices' for corporate governance. Some of the tax regulations that the IRS enforces contain concepts that parallel state laws on fiduciary duties. Boyce et al. (2007) state that whilst IRS recommendations are not mandatory standards, they do

reflect the kinds of processes that the IRS will consider when investigating private benefit and excess benefit abuses by NFP organisations.

They go on to say that state attorneys general investigating NFPs will possibly consider the extent to which organisations have implemented the recommendations provided by the IRS. Boyce et al. (2007) say that there may be greater level of accountability for NFP organisations with the introduction of the IRS's recommendations. Donors and other private interest groups are likely to compare an organisation's behaviours with these recommendations and call to task any organisations that seem to fall short.

Cain (2008) also used IRS standards to draw out 'best practice' principles for NFP governance. According to Cain (2008), one of the key roles of the governing board is to review the compensation of executive management. The IRS encourages NFP boards to have reasonable remuneration processes. The IRS also expects organisations to have a remuneration policy for officers and key employees, consisting of approval by independent individuals using benchmarks to support their decision (Cain, 2008).

According to Cain (2008), the IRS encourages organisations to have written document retention policies and audited financial statements. Organisations are persuaded to have an audit committee to oversee the independence and competence of the auditors.

The IRS recommendations and the Sarbanes-Oxley Act (US) merit consideration, and the 'best practice' principles will be used as a basis to draw out a model of best practice for small NFP organisations further in this chapter. Although the IRS called these recommendations 'standards' instead of 'best practices' or 'good governance practice', they believe that following these practices will increase the success rate of NFP organisations in carrying out their mission (Boyce et al., 2007).

Boyce et al. (2007) conclude that NFP organisations that implement the IRS's recommendations may decide, at a minimum, to take the following actions:

- Implement a detailed conflicts of interest policy suitable for the organisations.
- Provide a workshop on corporate governance.
- Conduct regular self-evaluation of governance effectiveness.

Although they are not mandatory, adopting the IRS’s standards allows NFP organisations to use the recommended practices to strengthen their internal controls and improve their activities (Boyce et al., 2007).

### 4.3 ‘Best Practice’ research framework

Several key arts and cultural NFP organisations, both large and small, have experienced financial crisis (Turbide et al., 2008). They have discovered that success in carrying out good programs has not translated into good financial management (Turbide et al., 2008). Having looked at problems in financial controls and governance that affect the financial management of small NFPs, it is evident that the question of ‘What is best practice?’ should be investigated.

This research framework will be carried out by first studying the six significant studies below and drawing out ‘best practice’ principles. After investigating and identifying ‘best practice’ for NFP organisations, a model code of conduct for small NFPs will be developed.

**Table 4.1 Significant studies**

Reference	Best practice standards set by:	Best practice principles Organisations should:
<i>The board member perspective on best practice in nonprofit governance</i> (Marx & Davis, 2012a)	No. 1 (Marx & Davis, 2012b) No. 2–6 (Moyers, 2012)	<ol style="list-style-type: none"> <li>1. have a well-defined and structured governance relationship between the board and executive management .</li> <li>2. engage in formal evaluation.</li> <li>3. have an effective board member recruitment and orientation.</li> <li>4. have a clear mission and vision.</li> <li>5. establish long-term objectives.</li> <li>6. plan programs.</li> </ol>

<p><i>Best practice in nonprofit governance: dealing with voluntary reforms</i> (Boyce et al., 2007)</p>	<p>IRS</p>	<ol style="list-style-type: none"> <li>1. ensure board composition is not too small or large.</li> <li>2. have a mission statement.</li> <li>3. develop a code of ethics and whistleblower policy.</li> <li>4. exercise due diligence when reviewing transactions.</li> <li>5. familiarise with the organisation's activities.</li> <li>6. avoid conflict of interests.</li> <li>7. demonstrate transparency.</li> <li>8. monitor professional fundraising.</li> <li>9. conduct financial audit.</li> <li>10. ensure reasonable compensation for services.</li> <li>11. have a document retention policy.</li> </ol>
<p><i>Commentary: Good governance, best practices for nonprofits.</i> (Cain, 2008)</p>	<p>IRS</p>	<ol style="list-style-type: none"> <li>1. ensure board is the right-size.</li> <li>2. review compensation of key employees.</li> <li>3. develop a conflict of interest policy.</li> <li>4. have an investment policy.</li> <li>5. ensure that fundraising done in compliance to the law.</li> <li>6. keep governing body minutes and records.</li> <li>7. develop a document retention policy.</li> <li>8. develop an ethics and whistleblower policy.</li> <li>9. audit financial reports.</li> <li>10. ensure transparent and accountable dealings.</li> </ol>
<p><i>Sarbanes-Oxley and fiduciary best practice for officers and directors of nonprofit organisations</i> (Weidenfeld, 2004)</p>	<p>Sarbanes-Oxley Act (US)</p>	<ol style="list-style-type: none"> <li>1. ensure duty of care.</li> <li>2. ensure duty of loyalty.</li> <li>3. distribute periodic fiscal reports.</li> <li>4. have an audit committee on the Board of Directors.</li> </ol>
<p><i>OECD principles of corporate governance</i> (OECD, 2004)</p>	<p>OECD</p>	<ol style="list-style-type: none"> <li>1. ensure the basis for an effective corporate governance framework.</li> <li>2. protect and facilitate the exercise of shareholders' rights.</li> <li>3. ensure the equitable treatment of all shareholders with opportunity to redress for violation of their rights.</li> <li>4. recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.</li> <li>5. ensure that timely and accurate disclosure is made on all material matters regarding the corporation.</li> <li>6. ensure the strategic guidance of the company, the effective monitoring of management by the board,</li> </ol>

		and the board's accountability to the company and the shareholders.
<i>Corporate governance best practices: The proof is in the process</i> (Dalton & Dalton, 2006)	(Dalton & Dalton, 2006)	<ol style="list-style-type: none"> <li>1. ensure that all board member are independent of each other.</li> <li>2. ensure directors engage in constructive debate.</li> <li>3. provide directors with written and oral forms of communication with sufficient time to review.</li> <li>4. do not delegate board responsibilities to sub committees.</li> <li>5. require board members to operate with integrity.</li> </ol>

#### 4.4 'Best practice' discourses

The above literature-informed best practice principles will be discussed below. After a brief discussion on each best practice with regard to its suitability for small NFP organisations, the principles that are relevant for small NFP organisations will be extracted to draw up the model of best practice for small NFP organisations in Australia in the next section. Some of the principles are repeated by other studies so, they will only be discussed once. Some of the principles are also combined and discussed together because of their similarity.

1. A well-defined and structured governance relationship should exist between the board and executive management.

It is important that NFP organisations have a well-defined and structured governance relationship between the board and executive management (Marx & Davis, 2012a, 2012b). Good governance requires a strong partnership between the board and the chief executive (Moyers, 2012). For this partnership and the system to work, each party has to do his or her job (Moyers, 2012). Highly skilled directors without clear roles and responsibilities can result in inefficiency and board frustration (Marx & Davis, 2012a).

In a small NFP organisation that may have only a small number of employees, it can be easy for the directors to play a more hands-on approach to governance. This may cause problems when there is no clear delineation between management and governance duties. To avoid such

problems, it is useful to have a well-defined and structured governance relationship between the board and executive management as mentioned by Marx and Davis (2012a).

This principle will be reworded as, 'A small NFP organisation must have a well-structured governance relationship between the board and the CEO'.

2. The board must actively engage in formal evaluation.

Marx and Davis (2012a) maintain that in theory, a large part of NFP organisations adhere to the policy governance model, where the board delegates specific management roles and responsibilities to the CEO. The CEO is responsible for achieving organisational outcomes through the monitoring of the organisation's performance.

The organisational outcomes must be set by the board, preferably with the input of the CEO. It is the board's responsibility to determine organisational outcomes and how to measure them. Once this is determined, the CEO can be instructed to meet those outcomes with periodic evaluation.

This principle is appropriate to be adopted as a 'best practice' model for small NFP organisations that may only have one manager working with volunteers. This single employee can be guided by the board to achieve organisational outcomes.

This principle will be reworded as, 'A Board of Directors of a small NFP organisation must actively engage in formal evaluation'.

3. An organisation should have an effective board member recruitment and orientation process.

Only in special cases will a small NFP organisation with limited resources be able to attract a very highly skilled CEO. With limited resources and a moderately skilled CEO, the board of a small NFP organisation needs to attract directors with very specific skills to compensate for the organisational shortcomings. It is therefore important that boards of small NFP

organisations have an effective policy on board recruitment. This could also avoid duplication of skills on the board.

An orientation process should also be carried out so that new directors can settle into their roles without much difficulty. This includes an induction on the activities of the organisation and what is expected of the new director. Boyce et al. (2007) include in their list of principles, the need for directors to be familiar with the organisation's activities.

This principle will be reworded to read, 'A small NFP organisation must have an effective board member recruitment and orientation process'.

4. A small NFP organisation must have a clear mission and vision and establish long-term objectives.

According to Marx and Davis (2012a), a NFP organisation must have a clear mission and vision. This recommendation is supported by Boyce et al. (2007) in their principles of best practice.

The IRS of the US suggests that NFP organisations should communicate the purpose of the organisation's existence, what its objectives are, the beneficiaries and its activities (Boyce et al., 2007). The clearly articulated mission statement will assist directors to understand the organisation and their fiduciary responsibilities (Boyce et al., 2007).

This principle will be reworded to read, 'A small NFP organisation must have a mission statement which includes its mission, vision, activities, beneficiaries, and long-term objectives'.

5. A small NFP organisation must have a program plan.

As mentioned in Chapter Two, the NFP sector is made up of organisations aimed at creating social value for society (Lettieri et al., 2004; Lyons & Passey, 2006). The services are created for a community purpose (Productivity Commission, 2010) and are important providers in the health, education, culture, sport and hospitality industries (Lyons & Passey, 2006).

Marx and Davies (2012a) suggest that all NFP organisations have a program. Without a program, a NFP organisation is just an empty organisation. Programs are the foundation stone of a NFP organisation and for that reason the CEO and Board of Directors must know in advance what programs they will be running the following year. The program should be planned based on the organisation's strategic direction and budget. During the program planning meetings, the directors and CEO must consider what funds will be allocated to each program, how many workers are needed and what outcomes they will get from them. A small NFP organisation may run programs on a small budget and be less innovative but, nevertheless, their programs must be planned. By planning and adopting the program at a board meeting ensures that the board of directors is aware for the organisation's programs and plans.

This principle will be reworded to read, 'A small NFP organisation must adopt its following year program at a board meeting'.

6. Board composition should not be too small or too large.

Board size has been the subject of much research (Forbes & Milliken, 1999; Golden & Zajac, 2001; Hardwick, Adams, & Zou, 2011; Shan & Xu, 2012; Van-Ness, Miesing, & Kang, 2010).

When giving recommendations to NFP organisations, the IRS did not articulate any precise formulation for board size or composition. What the recommendations did specify was that a small board would not have sufficient representation of the public and a large board may be less attentive to their supervisory functions (Boyce et al., 2007).

The recommendations also state that successful boards should include not only individuals who are knowledgeable and passionate about the organisation's activities, but also those with expertise in key areas such as accounting, finance, compensation and ethics. Although these are arguably

sound as general principles, the unique circumstances of different charities may merit different approaches to board composition (Boyce et al., 2007).

Although the IRS states that a NFP Board must not be too small or too large, it does not give a recommendation of an appropriate board size. For that reason, the standard set by the reserve trust mentioned in Chapter Three will be adopted for the purpose of this research. A Trust Board must have three to seven members (Land and Property Management Authority, 2010).

This principle will be reworded to read, 'A small NFP organisation must have three to seven members'.

7. A small NFP organisation should have a code of ethics and whistleblower policy.

The IRS encourages NFP organisations to develop a code of ethics policy that describes behaviours it supports and those that it discourages. This general concept may best be understood as fostering an overall culture of compliance, consistent with the fiduciary duty of directors to ensure that charitable organisations satisfy applicable legal requirements (Boyce et al., 2007).

The IRS also recommends a whistleblower policy be in place (Boyce et al., 2007) and has established a Whistleblower Office. The purpose of this office is to respond to allegations of tax abuse in excess of \$2 million, but later legislation lowered that to \$20 000 (Boyce et al., 2007). If the legislation was maintained at investigating tax abuses of over \$2 million dollars, it would have been deemed unnecessary to include this recommendation in the model of best practice for small NFP organisations. However, since this figure has been lowered to \$20 000, it falls within the income range of a small NFP organisation in Australia. The IRS whistle blower policy is only for tax abuse.

In the case of NFP organisations in Australia, a whistleblower policy could cover not only tax fraud, but also the misuse of funds and conflict of interest

abuse. For a small NFP organisation, a general protection clause would be more appropriate for a whistleblower. This is because in the case of reporting a misuse of funds or the potential for a conflict of interest, a small NFP organisation may not be able to afford to remunerate whistleblowers. Instead of a financial reward, an employee could be guaranteed job protection, members may receive membership protection and a board member may be assured protection for his or her board position.

This principle will be reworded to read, 'A small NFP organisation must have a code of ethics which includes protection for whistleblowers'.

8. Exercise due diligence when reviewing transactions and duty of care.

One of the board's responsibilities is to exercise independent judgment and ask reasonable questions about the information being presented by management (Moyers, 2012).

Directors are subject to certain common law duties, such as duty of care, which requires them to make decisions in their capacity as directors on a reasonably informed basis (Weidenfeld, 2004). The IRS define the duty of care as requiring directors to act in good faith, which is the same level of care an ordinarily sensible person would exercise under similar circumstances and in the NFP organisation's best interests (Boyce et al., 2007).

To achieve this, the IRS recommends the NFP Boards of Directors develop policies and procedures to ensure that all directors are familiar with the organisation's activities, are fully aware of the organisation's financial state and make informed decisions based on full and accurate information (Boyce et al., 2007).

This principle will be reworded as, 'A Board of Directors of a small NFP organisation must exercise due diligence by being fully informed of matters pertaining to transactions when reviewing them'.

#### 9. Directors be familiar with organisation's activities

In Nos. 3 and 8 above, one of the best practice recommendations is for boards to have an effective recruitment and orientation process. In the orientation process the new director is expected to be inducted with the organisation's activities (Boyce et al., 2007). For that reason, this principle will be omitted.

#### 10. Board of directors should avoid conflicts of interest and exercise a duty of loyalty.

According to Cain (2008), conflicts of interest arise when decisions are made by persons with interests that are contrary to the interests of the organisation. The IRS encourages NFP organisations to develop a conflict of interest policy that requires individuals to act solely in the interests of the organisation and not for their own personal interests (Cain, 2008). It is the responsibility of the board to regularly evaluate the policy, identify potential conflicts and adopt a course of action to avoid it (Boyce et al., 2007; Cain, 2008).

Loyalty towards one's organisation prevents self-dealing and fraud (Weidenfeld, 2004). There must be faithful pursuit of the interests of the corporation rather than the director's own interests. However, not all dualities of interest are conflicts of interest that implicate the duty of loyalty. Directors' duty towards their organisation obligates them to avoid conflicts that would be detrimental to the NFP organisation (Boyce et al., 2007).

This principle will be reworded as, 'A small NFP organisation must have a conflict of interest policy that is regularly evaluated'.

#### 11. Board of directors must demonstrate transparency in all their dealings.

A NFP organisation must demonstrate transparency in all its operations. This would include being transparent about its mission, activities and finances (Boyce et al., 2007). In the US, the IRS recommends that NFP organisations post their Form 990, annual reports and financial statements online (Boyce et al., 2007). In Australia, NFP organisations are required to register at the

ACNC portal where, the names of the individual directors and the organisation's financial report is attached. This is available online for anyone to view.

Boyce et al., (2007) say that there are some limits to transparency. For example, strategic planning objectives of an organisation can remain confidential.

This principle will be reworded as, 'A small NFP organisation must demonstrate transparency in all its operations and demonstrate this transparency by registering its organisation at the ACNC portal'.

#### 12. Monitor professional fundraising.

Fundraising must always be carried out in compliance with the law. In the US, the IRS recommends that NFP organisations adopt and monitor policies to ensure that fundraising activities are done according to the laws of the country (Boyce et al., 2007)

In Australia, state governments administer fundraising permits. In NSW, it is the NSW Office of Liquor, Gaming and Racing (OLGR), which sits within NSW Trade & Investment, which is accountable for the development, implementation and integrity of the overall regulatory framework across alcohol, licensed clubs, charitable fundraising and gambling activities in NSW (Office of Liquor Gaming and Racing, 2014).

The *Charitable Fundraising Act 1991* regulates the fundraising activities and requires that before an organisation conducts charitable fundraising activities it is required to hold a licence to fundraise. Licences to fundraise are subject to conditions. A licence to fundraise is obtained by lodging a completed Charities Fundraising application. When the application is approved, the organisation will be given a licence to fundraise, which is called an 'authority to fundraise' (Office of Liquor Gaming and Racing, 2014).

This principle will be reworded as, 'A small NFP organisation must have an authority to fundraise before it engages in fundraising activities'.

### 13. Conduct financial audit.

Directors of any organisations must be good stewards of the organisation's resources. By this, it means that it is the responsibility of the directors to avoid waste. There are a few good recommendations below which can be adopted by small NFP organisations.

The IRS standards suggest that board oversight of expenditures is necessary to ensure that the NFP organisation operates within its approved annual budget, and the IRS encourages organisations of all sizes to conduct some level of financial review. The IRS also recommends changing audit firms at least every five years to ensure that the organisation's books are looked at by new people so that what was missed may be caught by fresh eyes. The Sarbanes-Oxley Act, however, requires public companies to change auditors within an audit firm or with a new firm (Boyce et al., 2007). The IRS recommend that smaller NFP organisations with smaller budgets engage a Certified Public Accountant (CPA) to conduct an annual audit (Boyce et al., 2007).

This principle will be reworded as, 'A small NFP organisation must have their books reviewed by an independent CPA every year. A new CPA must be appointed every 5 years'.

### 14. Compensation paid for services is not excessive.

The recommendations made by the IRS encourage NFP organisations to adopt practices to ensure that all payments made for services are reasonable (Boyce et al., 2007). This could be done by getting quotes from different service provider for a job and choosing the service provider with the most competitive price. There may be times that a CEO may wish to choose a service provider who has quoted a higher price because he or she may be more reliable or does a higher quality job. The treasurer on the board should

check invoices thoroughly or randomly select a few invoices to examine. This will inform the treasurer if payments made for services are reasonable.

This principle will be reworded as, 'A small NFP organisation must ensure that reasonable payments are made for services by getting quotes'.

15. NFP organisations should have a document retention policy.

The IRS recommends that NFP organisations develop a document retention policy. This includes electronic files and their handling, backup procedures, archiving and reliability checks (Boyce et al., 2007). This is in keeping with the Sarbanes-Oxley Act, which makes it a crime that is punishable by a fine and up to 20 years in prison, to alter or hide corporate records with the intent to prejudice an investigation (Boyce et al., 2007). Not only is it important to maintain operational files, it is also vital to retain governing body minutes, business papers, correspondences and other records.

This principle will be reworded as, 'A small NFP organisation must have a document retention policy'.

16. Board of directors should review compensation for key employees.

Organisational structures look very different between small and large businesses (Ingram, 2014). This is also the case with small NFP organisations, which generally have fewer layers of management and fewer employees in their organisational chart. Small business organisational charts are often flat (Ingram, 2014).

Employees of small businesses or NFP organisations may be responsible for a wider range of tasks than employees with similar job titles in larger businesses. Many of the tasks normally assigned to managers in corporate businesses are often given to lower-salaried employees in a small business (Ingram, 2014). This is also the case with a small NFP organisation with a smaller workforce. An employee with a simple title and low salary may be required to perform jobs that may be assigned to a higher level employee in a larger organisation. For that reason, Boards of Directors should review

compensation for key employees from time to time to take into consideration their tasks and to determine if they are reasonably compensated.

This principle will be reworded as, 'Key employees' remuneration must be reviewed annually in a small NFP organisation'.

#### 17. Small NFP organisations should have an investment policy.

According to Cain (2008), increasing number, of NFP organisations are entering into complex and sophisticated investments that require the expertise of investment advisors. The IRS recommend that they establish written investment policies that protect the assets of the organisation (Cain, 2008).

Although small NFP organisations in Australia have gross receipts of under \$250 000, they may invest funds set aside for staff long service leave or emergency reserve funds. It is important, therefore, for small NFP organisations to have an investment policy. This will also be useful when small NFP organisations grow into large organisations. These funds must be invested wisely and avoid excessively risky investments.

The principle will read, 'A small NFP organisation must have an investment policy'.

#### 18. Ensure there is distribution of periodic fiscal reports.

Boards of Directors must ensure that financial reports are provided to them regularly, as it is their fiduciary responsibility to maintain sound financial practices. According to Moyers (2012), most board members on NFP boards are volunteers. Many may not be familiar with reading financial statements and may not be able to recognise when the organisation is in financial crisis (Moyers, 2012). It is, therefore, important that directors of small NFP organisations be trained to interpret financial statements and understand their ramifications for the organisation.

The principle will read, 'Board of Directors of small NFP organisations must ensure that financial reports are provided to them regularly and that they have the ability to interpret them'.

19. Small NFP organisations should have an audit committee on the Board of Directors.

In a large corporation or NFP organisation, it may be necessary to have an audit committee on the Board of Directors. This may be unnecessary in a small NFP organisation that has a board of only three to seven members. Moreover, as mentioned above, all directors of small NFP organisations must have the ability to interpret financial reports. Thus, having an audit committee on the Board of Directors is unnecessary for small NFP organisations. This principle will not be included in the best practice.

20. Ensure the basis for an effective corporate governance framework.

According to the OECD's corporate governance best practice document, the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities (OECD, 2004).

The corporate governance of a small NFP organisation will have the framework above if all the principals discussed from 1–19 above are carried out. This includes the discussions on having ethical practices, demonstrating transparency, conducting financial audits and having a conflict of interest policy. Therefore, the principal on ensuring the basis for an effective corporate governance framework is too general to be included in the best practice model for small NFP organisations.

21. The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

Since NFP organisations do not have shareholders, this 'best practice' principle is not relevant to this research. The corporate governance framework should ensure the equitable treatment of all shareholders,

including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

22. The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

If directors make decisions in their capacity as directors with the best interest of the organisation in mind, undertake annual audits and carry out all the checks and balances mentioned in the previous recommendations, it will gradually ensure the sustainability of the organisation. This principle is too general and have been covered in greater in the principles above.

23. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Timely and accurate disclosures are vital for ensuring that the organisation is transparent in its dealings. In Australia, there are deadlines for the submission of financials to state authorities like NSW Fair Trading, the Land and Property Management Authority for reserve trusts, and other regulatory authorities. Funding bodies also require that acquittal of funds be undertaken before their deadline.

Since this is a good governance practice, the best practice principle will read, 'A small NFP organisation must meet its disclosure deadlines'.

24. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

This recommendation by the OECD has also been covered by other recommendations in greater detail.

25. Board of directors must be independent of the organisation and each other.

According to Dalton and Dalton (2006), the current recommendations for board independence do not adequately capture the notion of independence. To be classified as independent in most guidelines, a director must meet a series of requirements that include having no personal or professional relationship with the company or its management. Although it is a good policy, in practice, a director can be fully in compliance yet clearly not independent in spirit.

Dalton and Dalton (2006) give the example of a director who has been on a board for 12 years and plays tennis at least monthly with the company's CEO, something they both did since they were in college. By most guidelines, this director is independent, but he is not really independent in spirit, and his independence and his ability to critically evaluate the CEO may be compromised.

To encompass this principal of best practice, the statement will read, 'Directors on small NFP boards must be independent of each other and with the management in relations and in spirit'.

26. Directors to engage in constructive debate.

Another essential requirement for board effectiveness is for directors to engage in constructive debate amongst themselves and with management (Dalton & Dalton, 2006). It is the responsibility of the chairperson to encourage dialogue. Shying away from robust discussions might be because of the directors' fear of confrontation, board members' discomfort with conflict, board members' lack of skill or knowledge in how to engage in constructive, as opposed to destructive, debate, or meeting design that is heavily reliant on 'canned' presentations at the expense of active discussion (Dalton & Dalton, 2006).

The best practice principle will be worded, 'Directors of small NFP organisations must be open to discussing issues'.

27. Directors be provided written and oral forms of communication, such as board papers, with sufficient time to review.

Directors must be given sufficient time to review board papers prior to meetings. This will allow them time to obtain supplementary information should that be needed to enrich the board's discussion. This will also assist directors to fully consider meeting material.

The best practice principle will be worded, 'Directors are provided written and oral forms of communication, such as board papers, at least one week before a board meeting'.

28. Board responsibilities are not to be given to sub committees.

This particular principal of best practice is not necessary because a few principals above cover this requirement. If directors exercise due diligence when reviewing transactions, make sure that financial reports are provided to them regularly and ensure they have sufficient time to review business papers thoroughly, these directors absorb their fiduciary responsibilities and are not handing their responsibilities to anyone else.

For this reason, this principal of good governance is redundant.

29. Board members must operate with integrity.

This recommendation has been discussed and included in the discussion in No. 7 code of ethics, and in No. 8, in directors needing to exercise due diligence.

#### **4.5 Conclusion**

This chapter establishes that although there are no corporate governance models of best practice for small NFP organisations, existing models that are

available for FP or NFP organisations as a whole can be used. From six significant studies, 29 best practice principles were discussed for their suitability for small NFP organisations in Australia.

These 29 best practice principles, once discussed for their suitability for small NFP organisations, make up only 21 best practice principles. These 21 literature-informed best practice principles will be used for the proposed corporate governance model of best practice in the next research methodology chapter.

## Chapter 5: Research Methodology

### 5.1 Introduction

This leads to Chapter Five, which is the research methodology chapter. While investigating the background of NFP organisations, reviewing the literature on corporate governance and establishing the theoretical framework in the previous chapter, four research questions emerged.

These research questions are:

**Q1:** What are the significant corporate governance issues that exist in small NFP organisations in Australia?

**Q2:** Are there appropriate 'best practices' that can be included to develop a corporate governance model of best practice specifically for small NFP organisations in Australia?

**Q3:** Are small NFP organisations in Australia in a precarious state of survival and extinction?

**Q4:** Will a model code of conduct strengthen the governance of small NFP organisations in Australia?

In this chapter, the research methodology used to obtain the answers to the research questions will be outlined. This will include the objective, design and model of the study and the process for data collection and analysis.

This fifth chapter explains the methods and measures employed to conduct the investigation into the role of corporate financial control and governance mechanisms in the successful financial management of small NFP organisation in Australia.

This chapter presents information on the research methods that are identified to be a mixed-method research.

## **5.2 Research context**

Good governance practices and strong financial controls are vital for the success of not only FP corporations, but also for NFP organisations. The seeming lack of interest in small NFP organisations by researchers, regulatory bodies and the general public may create a governance environment where the fiduciary responsibilities of directors of small NFP organisations may be ignored.

The majority of studies in international corporate governance have focused on developing economies and their understanding of 'best practice' in corporate governance for companies (Brennan & Solomon, 2008). The Australian NFP sector has not been researched as widely and thoroughly as either the government or FP sectors (Steane & Christie, 2001).

Corporate governance mechanisms of accountability have traditionally been the focus of accounting and finance researchers (Brennan & Solomon, 2008). The issue of accountability has been researched as corporate accountability to shareholders (Brennan & Solomon, 2008). Corporate governance research on the whole has focused on listed companies, while finance studies have concentrated on internal company mechanisms relating to boards and board performance (Brennan & Solomon, 2008).

Steane and Christie's work of 2001 is built on an earlier Australian study by McDonald in 1993 on governance in the NFP sector (Steane & Christie, 2001). Although these studies were of NFP organisations, neither of them focused their study on small NFP organisations. International and Australian NFP studies on corporate governance seem to have the perception that 'one size fits all'.

A large proportion of literature on an effective NFP board use the responsibilities entrusted to boards of commercial enterprises to define the responsibilities of NFP boards (Turbide et al., 2008). Many scholars have forcefully challenged this best practice approach (Ostrower & Stone, 2006).

FP principles may be acceptable for large NFP boards, but small NFP boards face different challenges than commercial enterprises.

The distinctive governance context of NFP organisations was also studied by Parker (2007) when he researched board processes in two organisations. Just like other studies mentioned above, his study too does not differentiate between small and large NFPs. As mentioned above, although there are some studies on NFP governance, there does not seem to be much on small NFP organisations. What is even more lacking is 'best practice' models for small NFP organisations.

### **5.3 Research methodology**

#### **5.3.1 Research objective**

Due to the fact that there is limited governance, low monitoring and low accountability in small NFP organisations, there is a need for the development of good governance instruments.

The purpose of this research is to identify current corporate governance best practices that exist for FP and NFPs and propose a model of best practice for small NFP organisations in Australia. This is in the view of strengthening their governance structure with the intention of making it a more sustainable industry. As mentioned above, one way that the governance of such organisations can be built up is by developing a model of best practice and a code of conduct for directors. Currently, there is no literature in the area of best practice and a model code of conduct specifically for small NFPs.

The development of the above models will lead to improved governance that will enhance public trust and confidence. They would then support and sustain a strong and vibrant NFP sector. Chapter Five explains the methods and measures employed to conduct the investigation.

### **5.3.2 Research design**

Before a methodology can be chosen, it was necessary to review the literature to get a comprehensive understanding of the research problem under investigation. The literature review disclosed that corporate governance research is widening its scope of methodological approach and application of research techniques (Brennan & Solomon, 2008). With the development of corporate governance research, a variety of analytical techniques with a more interpretive methodological approach are being used (Brennan & Solomon, 2008).

There have been studies on corporate governance involving interviews and case studies (Matthews, 2005), and other research methods, such as questionnaires and surveys, are becoming increasingly common (Fitzgerald, 2001; Vermeer, Raghunandan, & Forgione, 2006). A more detailed participant observer methodology has also been used in corporate governance research (Parker, 2007).

There has been less work carried out on testing established hypotheses derived from finance theories and more on developing new theoretical models using a grounded theory approach to research (Solomon & Solomon, 2006). According to Brennan and Solomon (2006), there are a variety of analytical techniques that can be used for studies involving corporate governance, such as econometric techniques, content analysis and archival analysis. Studies employing mixed methodology perspectives are rare in the corporate governance area.

To increase the reliability of the research results, a combination of a few lines of enquiry stated in the previous paragraph were chosen. To better understand the current situation and to propose solutions, the first line of enquiry was to review the literature. Key themes and ideas had to be investigated and the gap determined. The literature revealed that there are no suitable models of best practice for small NFP organisations in Australia,

nor are there codes of conduct for directors of such organisations in Australia.

The literature further disclosed that 'best practice' models do exist for FP companies and NFP organisations (Boyce et al., 2007; Dalton & Dalton, 2006; Marx & Davis, 2012a; OECD, 2004; The Brazilian Institute of Corporate Governance, 1999; Weidenfeld, 2004). Although there are 'best practice' models for NFP organisations, there has not been any developed specifically for small NFP organisations.

Having reviewed the literature, four research questions emerge in the area of small NFP organisations in Australia. These research questions will be answered using the research design in Figure 4.1 below.

The first step will be to design a proposed model of best practice for small NFP organisations based on the review of the literature. Due to the gap in the literature, current 'best practice' models that exist for FP companies and large NFP organisations will be used to develop a literature-informed 'best practice' model for small NFP organisations in Australia.

From the newly developed proposed 'best practice' model, a set of questions will be developed to carry out an online survey. This will be the second line of enquiry. The questions will be designed to draw out the governance practices of small NFP boards. Data that is collected will then be analysed using SPSS 17.

The third line of enquiry is to carry out ten in-depth interviews followed by the fourth line of enquiry, which is a case study. The findings will then be interpreted to develop a model code of conduct for directors of small NFP organisations in Australia.

The fourth line of enquiry is to conduct a case study. Data collected from the case study will be analysed. The findings will be used to develop a corporate governance model of best practice for small NFP organisations in Australia

and a code of conduct for directors of small NFP organisations in Australia  
The research design is illustrated in Figure 5.1 below. The purpose of this figure is to show a simple linear progression and it is not meant to illustrate the complexity of the full research.



**Figure 5.1 Research design**

### 5.3.3 Research model

According to Mason (2013), studies by NFP researchers on the underlying behavioural patterns of charity remain underdeveloped. One method that is suitable is the randomised and controlled field experiment. According to Mason (2013), this method has rarely been chosen by researchers publishing in NFP journals. Mason reviewed nearly 500 articles published in the *Nonprofit and Voluntary Sector Quarterly* between 2000 and 2011 and found only three articles that used this methodology.

Mason (2013) argues that the leading theoretical models on charity should be tested using field experiments in partnership with NFP organisations. Mason states that research that combines industry input and academic theories have dual outcomes which is also supported by other researchers. Field experiments contribute to literature and build up the sector at the same time, thus providing valuable practical knowledge for NFP practitioners (Bushouse & Sowa, 2012), Mason, 2012).

Mason's randomised and controlled field experiment will be used in this research. The first part is to review the literature that already exists for financial and corporate governance. The literature-informed proposed model of best practice will be developed and transferred into a questionnaire.

The research design using a questionnaire is similar to the design employed in Marx and Davis' (2012a) study entitled, *The board member perspective on best practice in nonprofit governance*. Marx and Davis (2012a) used a self-administered questionnaire to obtain information from 193 NFP board members. They contacted the executive directors who were on the electronic mailing list of the New Hampshire Centre for Nonprofits in 2009. The executive directors were asked to forward an invitation to their board members to complete the online questionnaire. The New Hampshire Centre for Nonprofits also posted the links on its website and in its e-newsletter. Participants were asked to complete one questionnaire via SurveyMonkey, after which the data were transferred to an SPSS dataset for analysis.

Marx and Davis (2012a) studied their population according to the services they provided, such as human services, health, education, etc. To assess recruitment procedures and parties within the organisation involved in recruiting, Marx and Davis asked a series of questions. This was also done when considering factors involved in an individual's decision to join the organisation's board and how the board evaluates its performance (Marx & Davis, 2012a) .

Marx and Davis asked participating board members the format and planning of their board meetings as well as the responsibilities of individuals and sub-committees. A series of questions on fundraising were included to assess board members' involvement in fundraising activities (Marx & Davis, 2012a).

Participants were also asked to rate the level of involvement of each group in a series of tasks on a scale of 1 to 7. This was done in order to evaluate roles and responsibilities. These questionnaire items examined the extent to which various responsibilities were exclusive to board members or to the executive directors, or if they were shared among both (Marx & Davis, 2012a).

#### **5.3.4 Data collection and analysis**

Like Marx and Davis' (2012a) study, a quantitative approach will be taken to answer the above research questions. A survey in the form of a questionnaire will be the main instrument that will be used to collect data (Marx & Davis, 2012a). It will be a self-administered questionnaire, which will be employed to obtain information from CEOs of small NFP organisations in Australia. Each of the questions will have levels of agreement and disagreement for the CEOs to select in order to quantify their responses (Leedy & Ormrod, 2010).

The responses will be pilot tested. Based on feedback obtained from the pilot test, the questions will be streamlined and the response options further clarified (Arunachalam, 2012).

To reach the CEOs, the names and addresses of small NFP organisations will be obtained from the ACNC's online register. Small NFP organisations with an income of less than \$250000 will be chosen, whether they are incorporated associations or limited by guarantee. A letter, an information sheet and a copy of the questionnaire will be posted and sent by email to the CEOs of these NFP organisations inviting them to participate in an online survey by either completing the online survey or by completing the paper copy.

The online survey will consist of a questionnaire via SurveyMonkey (Marx & Davis, 2012a). This questionnaire will consist of one industry question, one question on the organisation's legal structure, three questions about the CEO, 30 corporate governance questions and 20 financial governance questions. The rationale for selecting these questions will be explained below in the research framework section.

The reason that financial governance was extracted from corporate governance and 20 questions solely on financial matters were asked was because the literature review revealed that in FP corporate governance studies, financial governance is part of corporate governance, while this was not the case with the NFP studies. Much of the NFP studies focused solely on board matters and omitted financial issues.

A rating format using the Likert scale will be employed for the online questions. Likert scales are a common ratings format for surveys (Allen & Seaman, 2007). In this research, six levels will be identified instead of the usual five or seven levels used in a Likert scale. The middle option is intentionally eliminated to avoid the risk of respondents taking the 'easy way' of choosing the neutral option (Allen & Seaman, 2007). Likert and others recommend that it is best to use as wide a scale as possible (Allen & Seaman, 2007); therefore, six instead of four levels have been chosen. Some questions will have an A/B/C applicable type of response.

The data collected will then be transferred to be analysed (Marx & Davis, 2012a). An automated method of analysis, SPSS 17, will be employed.

## **5.4 Research framework**

### **5.4.1 Literature-informed model of best practice**

From Chapter Four's analysis of the six significant studies of 'best practice' models, the following literature-informed model of best practice for small NFP organisations was developed.

1. A small NFP organisation must have a well-structured governance relationship between the board and the CEO.
2. A Board of Directors of a small NFP organisation must actively engage in formal evaluation.
3. A small NFP organisation must have an effective board member recruitment and orientation process.
4. A small NFP organisation must have a mission statement that includes its mission, vision, activities, beneficiaries and long-term objectives.
5. A small NFP organisation must adopt its following year program at a board meeting.
6. A small NFP organisation must have three to seven members.
7. A small NFP organisation must have a code of ethics that includes protection for whistleblowers.
8. A Board of Directors of a small NFP organisation must exercise due diligence by being fully informed of matters pertaining to transactions when reviewing them.
9. A small NFP organisation must have a conflict of interest policy that is regularly evaluated.
10. A small NFP organisation must demonstrate transparency in all its operations and demonstrate this transparency by registering its organisation at the ACNC portal.
11. A small NFP organisation must have an authority to fundraise before it engages in fundraising activities.

12. A small NFP organisation must have their books reviewed by an independent CPA every year. A new CPA must be appointed every five years.
13. A small NFP organisation must ensure that reasonable payments are made for services.
14. A small NFP organisation must have a document retention policy.
15. In a small NFP organisation, key employees' remuneration must be reviewed annually.
16. A small NFP organisation must have an investment policy.
17. The Board of Directors of a small NFP organisation must ensure that financial reports are provided to them regularly and that they have the ability to interpret them.
18. A small NFP organisation must meet its disclosure deadlines.
19. Directors on small NFP boards must be independent of each other and with the management in relations and in spirit.
20. Directors of small NFP organisations must be open to discussing issues.
21. Directors are provided written and oral forms of communication, such as board papers, with sufficient time to review.

The above literature-informed model of best practice will be turned into questions for the online survey. The purpose is to learn if the proposed model of corporate governance best practice is significant for small NFP organisations in Australia.

#### **5.4.2 Ethics approval process**

The University of New England's Human Research Ethics Committee is responsible for reviewing and approving or rejecting ethics applications. It applies a hierarchical level of review to applications for ethics approval (University of New England, 2015). The committee reviews ethical issues and the potential risks to participants presented by the research protocol. Risk is evaluated based on whether there is potential for harm, be it physical, psychological, social, economic or legal, or the potential to cause people to

feel that they have been treated disrespectfully (University of New England, 2015).

The ethics approval application form consists of the eligibility for expedited ethical review, project title, summary, chief investigator and all other researchers' details, identification of ethical issues, project details and the applicant's declaration. This form is to be attached with the information sheet for participants, a consent form and any other relevant documents, such as the questionnaire for the online survey and list of questions for the in-depth interview (University of New England, 2015).

Two applications for ethics approval were submitted to the Human Research Ethics Committee. The first was for the online survey and the second was for the in-depth interview and case study. Two separate applications were made because, initially, it was intended that only two lines of enquiry be carried out, which were the literature review of corporate governance best practice to formulate a proposed best practice for small NFP organisations in Australia and an online survey.

Upon the completion of the online survey it was decided that further investigation of the significant results would be necessary to confirm or refute the survey results. For that reason, an ethics approval application was submitted for the in-depth interviews and case study.

The committee assessed the applications based on their eligibility for expedited review. Both the applications were granted expedited review and received an approval number. The approval number for the online survey was HE14-044 and for the in-depth interview and case study was HE14-310.

When the ethics approval for the online survey was granted, the quantitative data were collected, and when the ethics approval for the in-depth interview and case study was granted the qualitative data were collected.

### 5.4.3 Mixed-methods research

What started as only two approaches to research has included a third approach, combining qualitative and quantitative research in a 'mixed-method' approach (Bryman, 2006). The three distinct approaches to research that have emerged are quantitative, qualitative and what is called multi-methods (Brannen, 1992), multi-strategy (Bryman, 2004), mixed-methods (Creswell, 2003; Tashakkori & Teddlie, 2003), or mixed methodology (Tashakkori & Teddlie, 1998) research.

The mixed-methods research approach has gained strong support in several applied fields (Tashakkori & Teddlie, 2003). Bryman (2006) carried out a study of 232 social science articles where a mixed-method research approach was adopted. A study of the research methods and research designs used indicated that on the quantitative side, structured interview and questionnaire research within a cross-sectional design dominated, while on the qualitative side, the semi-structured interview within a cross-sectional design was popular (Bryman, 2006).

Bryman (2006) indicated that quantitative and qualitative research can be combined at different stages of the research process, such as at the stage of formulation of research questions, sampling, data collection, and data analysis. Mixed-methods research also involves the collection and analysis of both quantitative and qualitative data (Niglas, 2004).

There are many justifications for combining quantitative and qualitative research such as *triangulation*, *complementary*, *development*, *initiation*, *expansion* (Bryman, 2006; Greene, Caracelli, & Graham, 1989; Niglas, 2004).

In this study, a mixed-method approach was also used for a variety of reasons. Firstly, it was used for the purpose of *triangulation*. By this, questions that produced significant results in the quantitative data collection

were used in the qualitative data analysis. It was also used to confirm the results of the quantitative data analysis.

Secondly, it was used to *complement* the results from one method with the results from another. Thirdly, a mixed-method research approach was used for *development purposes*, in that the results from the quantitative method were used to further develop the qualitative method. Lastly, this research approach was employed for the purpose of *expansion*, which is to further expand the results from one inquiry to the next.

### **i) Quantitative data collection**

#### ***Survey methodology***

Upon the approval of the online survey ethics application, the proposed model of best practice was converted into a questionnaire. Online survey was chosen to carry out this quantitative research because it has specific advantages. This type of survey provides an efficient method of collecting data and saves the researcher's time (Cooper & Schindler, 2003).

Online survey software such as SurveyMonkey is inexpensive compared to face-to-face interviews and it gives participants sufficient time to think about their answers (Bachmann & Elfrink, 1996; Cooper & Schindler, 2003). Participants are also able to participate in the survey after-hours while maintaining anonymity (Cooper & Schindler, 2003).

Since there are no literature indicating previous corporate governance research specific to small NFP organisations in Australia, it was important that NFP organisations nationwide were given the opportunity to participate in this survey. It is a quick way of gathering data from a wide geographical area (Bachmann & Elfrink, 1996; Cooper & Schindler, 2003) and from groups who are difficult to reach using other methods (Garton, Haythornthwaite, & Wellman, 1999; Wellman, 1997).

### ***Questionnaire development***

As mentioned above, the proposed best practice model from the literature review was converted into a questionnaire. Fifty-five questions were developed for the online survey. The questionnaire was divided into four sections. The first section was about the participating organisations. This was followed by three questions about the CEO. The third and fourth sections were made up of 30 corporate governance questions and 20 financial governance questions. The questionnaire can be seen in Appendix A.

The first section was made up of two questions. Since all types of organisations are affected by their style of operation, industry, governance structures, value systems and the legal structure under which they operate (Ott, 2001), it was important to include two questions about the organisation. The first question is about the organisation's industry and the second question is about its legal structure.

The second section was questions about the CEO. The CEO information was included in the questionnaire because leadership in a NFP organisation does not only rest with the board, but also senior management. Some CEOs, especially of small NFP organisations, are also ex-officio members of the board, while some chairpersons of the board also act as the CEO.

The traditional model of a NFP organisation emphasised leadership responsibility being in the hands of the NFP board (Shamima, 2005). However, many studies in the 1970s and 1980s found this to be not the case. Some scholars argue that true leadership in most NFP organisations lies with the executive (Herman & Heimovics, 1994).

In Ahmed Shamima's (2005) study entitled, *Desired competencies and job duties of non-profit CEOs in relation to the current challenges: Through the lens of CEOs' job advertisements*, he studied NFP leadership by analysing competencies and job duties of CEO positions in the classified section of *The*

*Nonprofit Times* from the 1999 to 2004. The objective was to assess their relevancy and adequacy in dealing with current challenges of the sector. Findings from his study showed that among those who listed educational requirement, a majority required that the CEO had a degree in academic areas related to the NFP (Shamima, 2005). It was, therefore important to include questions on the CEO's qualifications, age and gender.

The third section was made up of 29 corporate governance questions and one financial governance question. Although this was a corporate governance section, a financial governance question was included to determine performance.

### ***Delivering the survey***

The popularity of carrying out research using the internet increases as the cost of computer hardware and software continue to decrease (Fox et al., 2001; Nie, Hillygus, & Erbring, 2002).

Once the questions were entered into SurveyMonkey, a pilot was tested by typical respondents before the survey went live. The purpose was to identify and address design issues in order to ensure validity and user friendliness (Caudle, 1994).

From the ACNC register, CEOs of 308 small NFP organisations in Australia were invited to participate in this corporate and financial governance research. This was performed by sending them an invitation letter dated 23 May 2014, which is Appendix B. The CEOs were also sent an *information sheet for participant*. This can be seen in Appendix C. Only 127 organisations participated by completing an online survey on SurveyMonkey. From the 127 participants, only 106 of the questionnaires were complete, as 21 respondents started the survey but did not complete them, making them unusable.

The participation survey resulted in 34.42 percent response rate. The literature indicates that a 20 percent response rate is considered satisfactory

for postal questionnaires (Easterby-Smith, Thorpe, & Lowe, 2008) and this is also the rate for web-based questionnaires (Kierran, Kierran, Oylar, & Gilles, 2005). Therefore, the response rate of 34.42 percent is above the satisfactory level.

This high response rate could be because the participants were CEOs and they would understand the importance and need for a survey on corporate governance best practice, especially for small NFP organisations.

## **ii) Qualitative data collection**

### ***In-depth interviews***

In-depth interview data collection is a qualitative research technique that requires conducting intensive individual interviews with a small number of respondents to discover their view on a particular idea, program or situation (Boyce & Neale, 2006). An example is to ask participants about their experiences and opinions about particular issues (Boyce & Neale, 2006).

According to Boyce and Neale (2006), in-depth interviews are appropriate when detailed information is required about a particular program or issue. They go on to say that interviews are often used to provide context to other data by offering a more complete picture of a particular issue (Boyce & Neale, 2006). For the reason above, the in-depth interview was chosen to follow on from the online survey.

### ***Interview questionnaire development***

The online survey questions that showed significant results were extracted. These questions were then expanded to include probing questions to elicit more detailed information. These questions can be seen in Appendix D. The purpose was to draw out information with more depth about individual NFP organisations. Probing questions like the ones used in Marx and Davis' (2012a) study will be used in this line of enquiry.

Since this study is about corporate governance and the online survey was completed by CEOs, it was now important to include the directors' perspective in the research. Therefore, the chairpersons of twelve organisations were invited to participate in the in-depth interviews. This approach will bring more comprehensive information about the corporate governance issues faced by the small NFP organisation from the perspective of management and the board.

### ***Interviewing process***

In-depth interviews began with a plan followed by a list or an interview program (Boyce & Neale, 2006). Those who were invited to participate in the in-depth interview were sent an invitation letter dated 10 November 2014 as can be seen in Appendix E, an *information sheet for participants* like the one in Appendix C and a consent form for them to read and sign, which is included as Appendix F. Only those who signed were interviewed. An audio recording of the interviews were made so that the information could be recalled accurately. When the interview started, each participant was asked if they still consented to be interviewed. When they agreed, the interview was carried out. This gave them another opportunity to reconsider if they had changed their mind between the time they signed the consent form and when the interview took place.

Those interviewees who were geographically distant, they were interviewed by telephone. The interviewees were informed that since the interviewer could not carry out the interview in person due to geographical distance and lacked the funds to travel to do a face-to-face interview, the telephone interview was selected because it is a cost-effective method to obtain data. The *UNE's Guidelines & Protocol for Conducting Telephone Interviews* was used to carry out the telephone interviews. These guidelines can be viewed in Appendix G.

According to Boyce and Neale (2006), the interviewer must be trained to elicit rich data from the participants. This, they say, can be done by making the interviewees feel comfortable, using suitable body language and being

interested in what they are saying. It is also important not to interrupt and give the interviewer's opinion.

The data obtained from the interviews will be analysed following Miles and Huberman's (1994) qualitative data analysis approach. This is the Thematic Matrix Analysis (Miles & Huberman, 1994). Based on the responses gathered from the chairpersons of the small NFP organisations operating in Australia, macro and micro thematic categories of importance will be identified. The frequency of the responses and the percentage of the macro and micro thematic categories will be reported and further compared with the significant statements obtained through the quantitative survey (Miles & Huberman, 1994).

### ***Case study process***

One of the in-depth interviewee was asked if he would be interested to participate in a case study. When he indicated that he was interested, it was decided to include the CEO as well in the interview to get a broader perspective of the organisation's governance and financial management issues.

The CEO was given an *information sheet for participants* like the one in Appendix C and a consent form for her to read and sign, which is included as Appendix F. Just like the in-depth interviews, an audio recording of the case study interview was made so that the information could be recalled accurately.

## **5.5 Conclusion**

Chapter Five presented the research methodology process adopted in testing the proposed theoretical framework. A mixed-method research was chosen and discussed. It was identified that to increase reliability, both quantitative and qualitative method will be employed.

Data collection methods such as online survey, in-depth interviews and a case study were discussed in great detail. The sampling plans, data collection process, design of the questionnaire, various data collection tools and different analytical approaches to handle quantitative and qualitative data were also described.

Logistic regression was identified to be statistically relevant to answer the research goals established for the quantitative investigation. Thematic matrix display tables were identified to be appropriate for qualitative data analysis. The next chapter will focus on quantitative data collection along with how the data will be analysed.

## **Chapter 6: Quantitative Data Collection and Results**

### **6.1 Introduction**

This chapter presents the results and findings of the quantitative data analysis. For the reasons outlined in the previous chapter, an online survey was chosen to carry out the second line of enquiry. The results of the online survey are first analysed using descriptive analysis.

Following the descriptive analysis, it seemed that performing a logistic regression analysis would provide an answer to one of the research questions. This was done using statistical package SPSS 17. This chapter summarises the results of the logistic regression analysis. This analysis was performed to reduce the problem of multi-co-linearity and to determine the potential relationship between financial performance of a NFP organisation and its corporate governance practices.

### **6.2 Merits of online survey**

Following the ethics approval, the proposed best practice model was used to develop a web-based survey questionnaire. This developed questionnaire was then uploaded to an online SurveyMonkey tool for data collection purposes.

As mentioned in the research methodology chapter, an online survey was chosen for data collection because it had many advantages. The main advantage that the web-based type of survey methodology offered for the present study is that it allowed the researcher the opportunity to reach a wider audience. As mentioned before, one of the main reasons why this method was chosen was to reach a wider audience (Bachmann & Elfrink, 1996; Cooper & Schindler, 2003) and from groups who are difficult to reach by using other types of research contact methods (Garton, et al., 1999; Wellman, 1997).

## 6.3 Descriptive analysis

### 6.3.1 Participating NFP organisations

From the 106 organisations that participated in the survey, 29 percent of the demography was of cultural and recreational nature, such as sports, art, museums, social and recreational organisations. The second highest group was from social services such as child welfare, youth services, family services, elderly and disabled people, emergency relief and income support.

The smallest group of participants, making up only 0.9 percent, was organisations from business, professional associations and unions, such as employers' organisations, trade unions and professional associations. The group that was not represented at all were philanthropic intermediaries and organisations for volunteerism promotion, such as grant-making trusts, fundraising organisations and intermediary organisations. The above information is evident in Table 6.1 and Figure 6.1 below.

**Table 6.1 Activities of the organisations**

Answer Options	Percent
Culture and recreation (sports, art, museums, recreational, social clubs).	27.4%
Education and research (schools, universities, TAFE, policy studies).	11.3%
Health (hospitals, rehabilitation, nursing homes, public health, health education).	9.4%
Social Services (child welfare, youth services, family services, elderly and disabled people, emergency relief, income support).	16.0%
Environment (conservation of natural resources, pollution control, animal protection, wildlife and countryside preservation).	8.5%
Housing ( Aboriginal Land Council, community housing)	4.7%
Employment (employment and training such as Jobs Australia, Joblink Plus).	3.8%
Law, Advocacy and Politics (advocacy organisations, minority groups, civic associations, legal services, crime prevention, rehabilitation of offenders, victim support, political parties).	7.5%
Philanthropic Intermediaries and Volunteerism Promotion (grant making trusts, fundraising organisations, intermediary organisations).	0.0%
International Activities (exchange programmes, development	3.8%

assistance, disaster relief, human rights and peace organisations).

Religion	3.8%
Business, professional associations and unions. (employers organisations, trade unions, professional associations.)	0.9%
Other (please specify)Other – please write in	2.8%

### Q2 Which of the following groups best describes your organizations activities?

Answered: 106 Skipped: 0

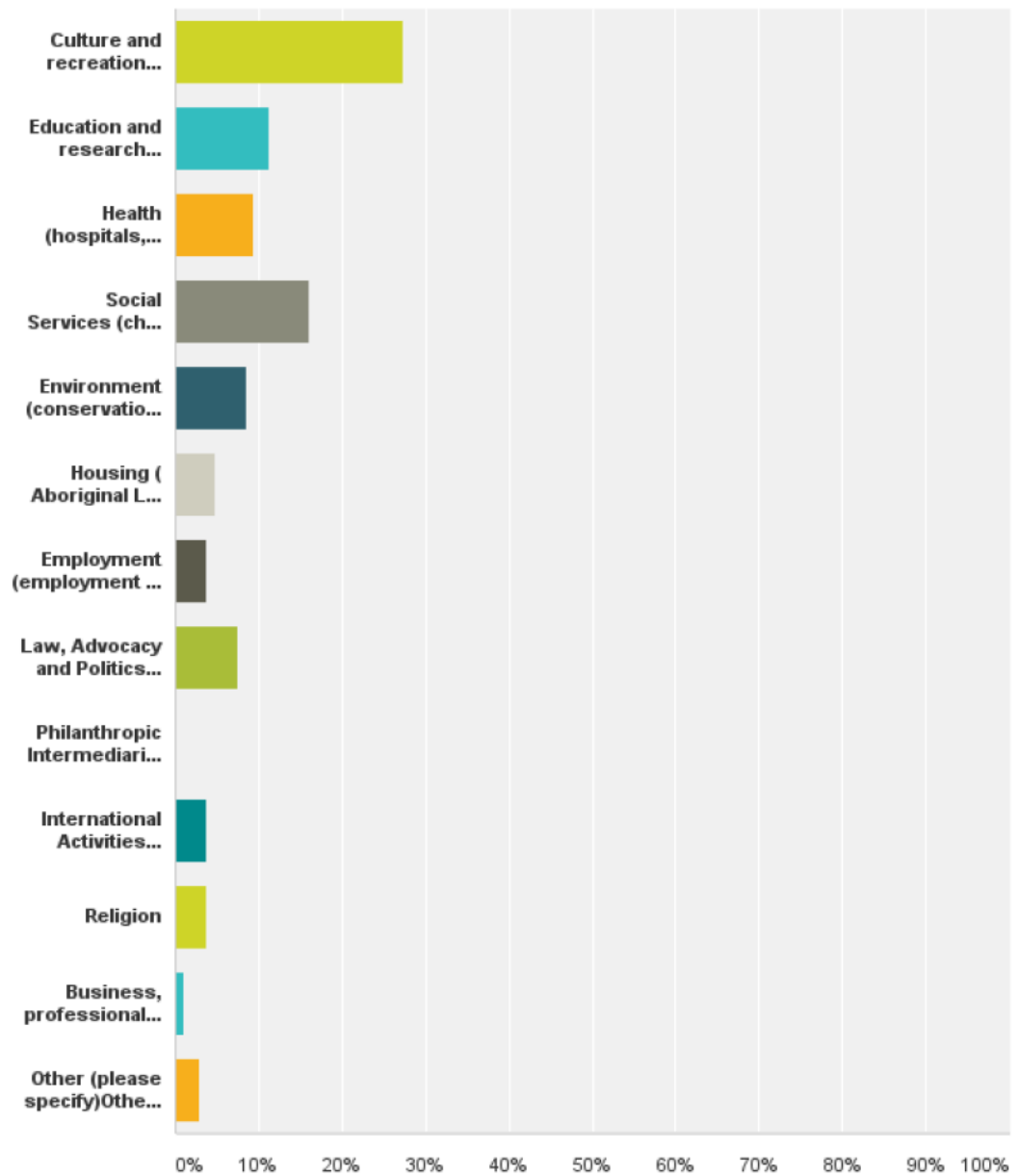


Figure 6.1 Activities of the organisations

The next question identifies the type of legal structure that the participating organisations have. The demographic profile of the participating organisations that responded to the survey is that 68 of the 106 were registered as incorporated associations, making up 64.2 percent of the respondents. The second largest group was registered under ASIC as a company limited by guarantee. This category made up 30.2 percent of the organisations participating in the study. These two categories add up to 94.4 percent of the sample. Only 5.6 percent of the sample derived from other legal structures such as body corporate and unincorporated association. These frequency distributions in the form of percentage representations are presented in Table 6.2 below.

**Table 6.2 Legal structure**

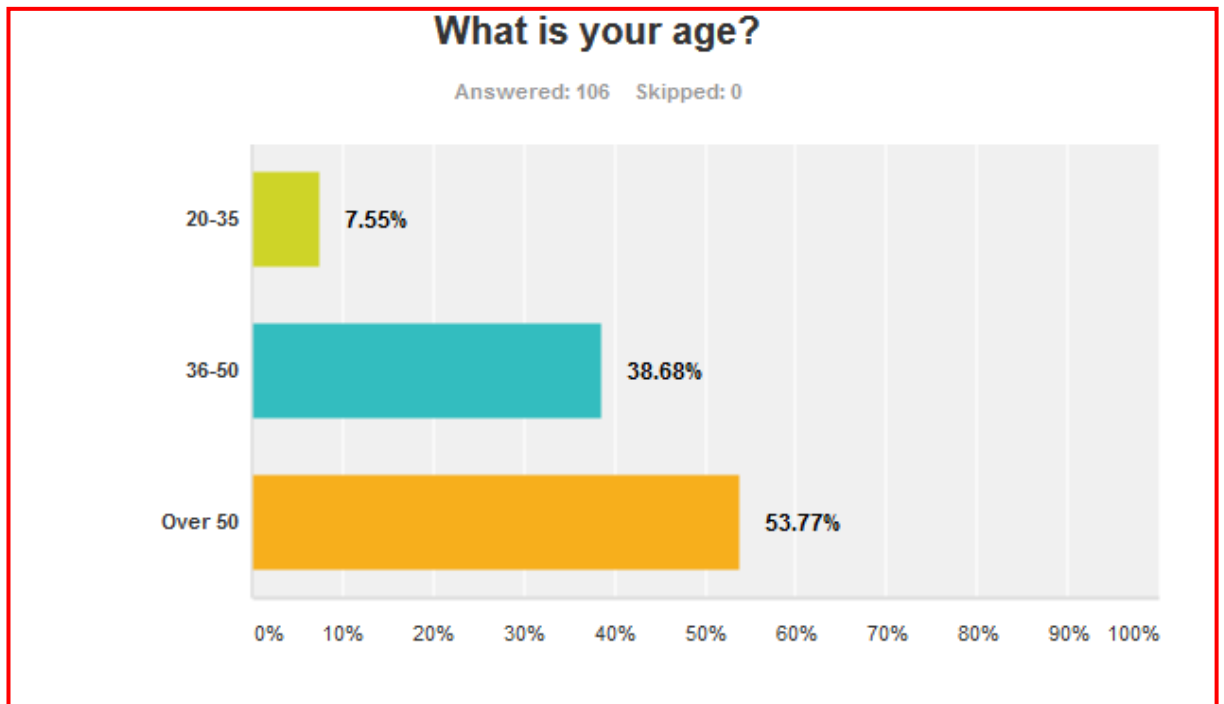
<b>What type of business structure best describes your organisation?</b>		
<b>Answer Options</b>	<b>Response Percent</b>	<b>Response Count</b>
Incorporated association	64.2	68
Company limited by guarantee	30.2	32
Co-operative	0.9	1
Body corporate	0.0	0
Other (see comments)	4.7%	5
Other - please state:		
<i>answered question</i>		106
<i>skipped question</i>		0

### **6.3.2 Participating CEOs**

As mentioned above, the next set of questions generated information about the demographic-related information of the CEOs. Of the 106 participants, 57 of them were over 50 years old representing over half of the sample at 53.77 percent. Approximately 7.55 percent of the respondents were within the age range of 20 to 35. A total of 41 of the respondents, making up to 38.68 percent were within the age range of 35 to 50 years. The information related to the distribution of the CEOs' age is shown in Table 6.3 and Figure 6.2 below.

**Table 6.3 CEOs' age range**

Answer Choices	Responses
20-35	7.55% 8
36-50	38.68% 41
Over 50	53.77% 57
Total	106

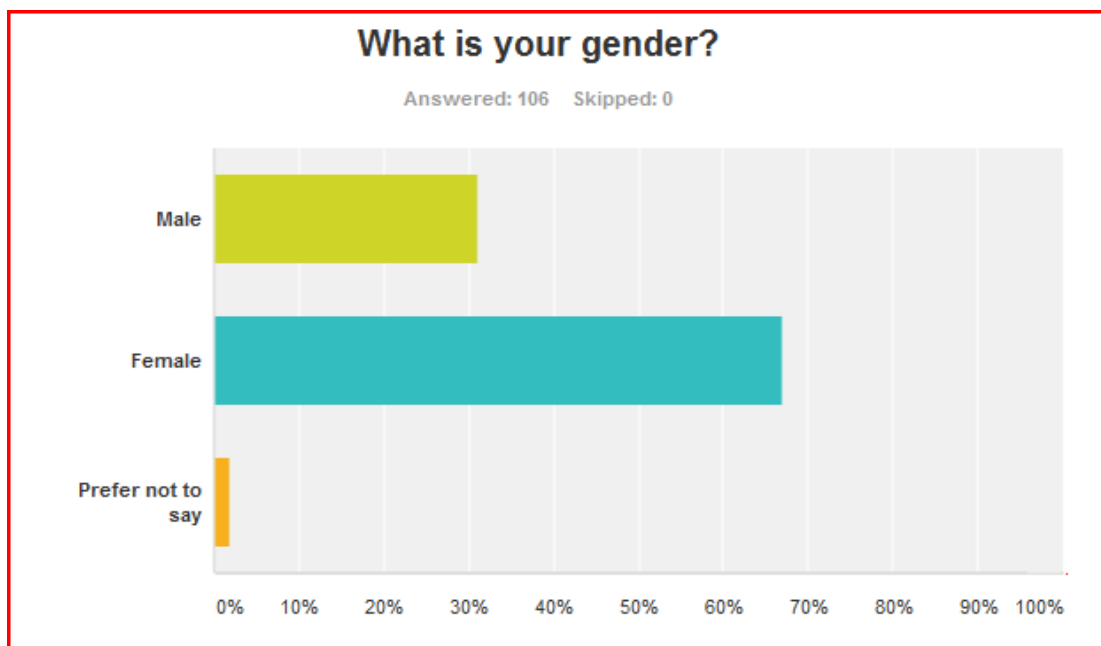


**Figure 6.2 CEOs' age range**

With regard to the gender variable, of the 106 respondents contacted, 71 (66.98%) were identified to be females, whilst 33 (31.13%) were identified to be males. There were two participants who were not prepared to identify their gender, accounting for 1.89 percent of total respondents. These results are represented in Table 6.4 and Figure 6.3 below.

**Table 6.4 CEOs' gender representation**

Answer Choices	Responses	
Male	31.13%	33
Female	66.98%	71
Prefer not to say	1.89%	2
Total		106

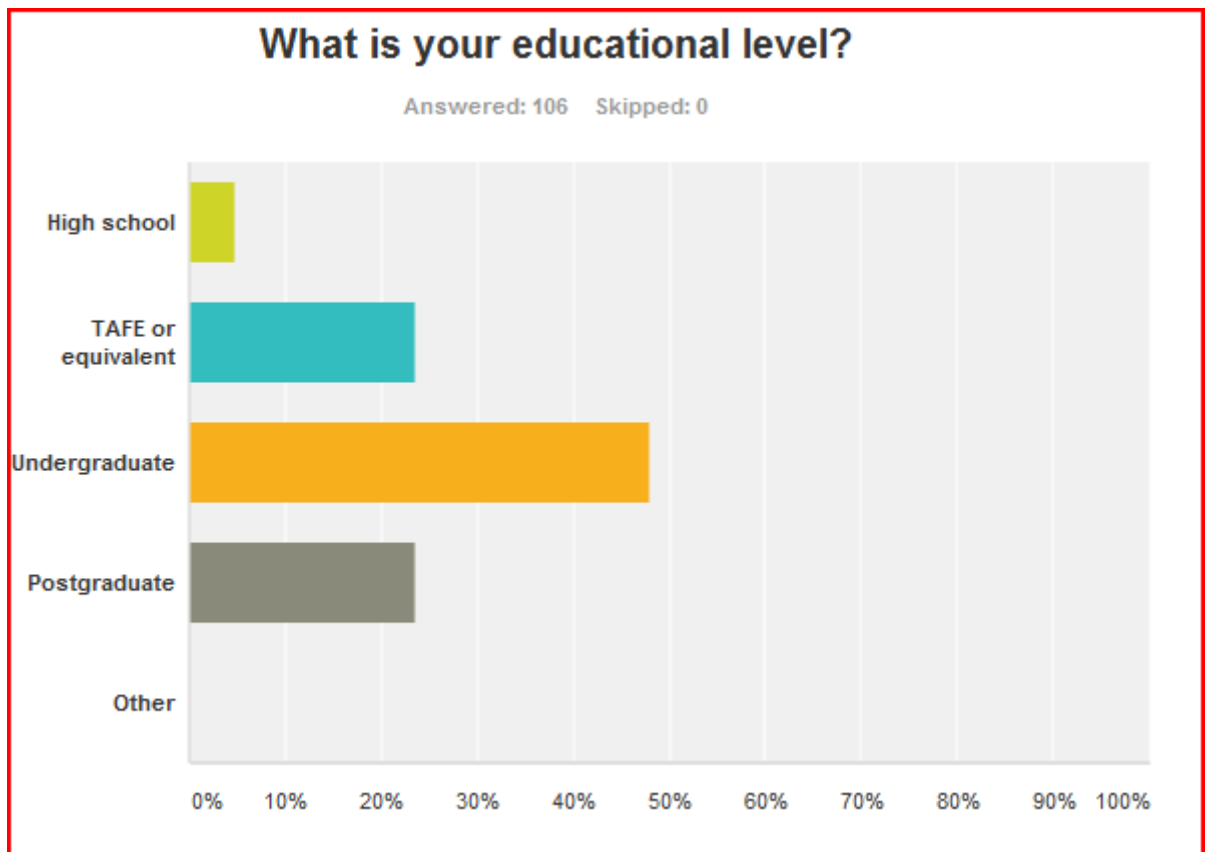


**Figure 6.3 CEOs' gender representation**

The majority of respondents had attained a higher educational level, with 48.11 percent having an undergraduate degree, and 23.58 percent having a postgraduate degree. From Figure 6.5 and Table 6.5, it is evident that the lowest qualification of the CEOs that participated in this research is high school level studies accounting for 4.72 percent of respondents. Approximately 23.58 percent of respondents in the sample possessed a TAFE or equivalent qualification. These results are represented in Table 6.5 and Figure 6.4 below.

**Table 6.5 CEOs' level of education**

Answer Choices	Responses
High school	4.72% 5
TAFE or equivalent	23.58% 25
Undergraduate	48.11% 51
Postgraduate	23.58% 25
Other	0.00% 0
Total	106



**Figure 6.4 CEOs' level of education**

### 6.3.3 Corporate governance practice

Thirty questions related to the practice of corporate governance were asked in this section. Each question had six options to choose from ranging from, different degrees of agreement to different degrees of disagreement. The three levels of agreement are 'strongly agree', 'agree' and 'somewhat agree'.

The three levels of disagreement are 'somewhat disagree', 'disagree' and 'strongly disagree'. Appendix H contains the results for the 30 corporate governance questions.

As mentioned in the research methodology chapter, the Likert scale was used in this research. However, instead of the usual five or seven levels used in a Likert scale, six levels were used. The middle option was eliminated intentionally to avoid the risk of respondents taking the 'easy way' of choosing the 'neutral' option (Allen & Seaman, 2007). Likert and others recommend that it is best to use as wide a scale as possible (Allen & Seaman, 2007); therefore, six instead of four levels were chosen.

The following section presents an in-depth descriptive analysis of the selection of the Likert scale options. In the analysis below, the responses falling within the 0–33.33 percent range will be considered low, the responses falling within the range of 33.34–66.67 percent will be considered moderate, while those within the 66.68–100 percent range will be considered high.

#### **i) Strongly agree and strongly disagree options**

Of the 30 questions in this section, only six questions produced a low response rate, representing the 'strongly agree' option. The lowest response rates were obtained for a question asked on whether the organisation has a whistleblower policy. This was followed by the question on document retention policy and on whether the organisation had built up cash levels over the past five years. These three questions produced below 30 percent of the response rate from the participants. This shows that a very small percentage of participants can state definitively that they have the two policies mentioned above or any cash built up.

Funding bodies are beginning to request a reserve ratio of 10–20 percent before they would fund an organisation (Arts NSW, 2015). According to their recently published pamphlet on frequently asked questions for their new

annual and multi-year funding, Arts NSW suggest that “achieving reserves of 10% is considered to be acceptable”, while “achieving 20% reserves is considered to be very good” (Arts NSW, 2015, p. 9).

Only one question on whether the surveyed organisations have a clearly articulated mission and vision produced a higher response rate. Approximately 75.47 percent of the organisations chose the ‘strongly agree’ option for this question asked. This result demonstrates that most organisations have a clear vision of where they would like to be in terms of the expansion plans.

The results related to ‘strongly disagree’ options all fall below 15 percent except for two questions. The question that produced the highest result of disagreement was whether the organisation has a whistleblower policy, where 66.04 percent of the participants chose ‘strongly disagree’. The other question was whether the organisation has a built up their cash level over the past five years. Approximately 25.47 percent of the participants chose ‘strongly disagree’ for this question. This shows that most organisations do not have a whistleblower protection policy, while a smaller percentage are very sure that they do not have cash built up, especially in the last five years.

#### **ii) Neither agree and neither disagree options**

Although every effort had been taken to avoid a ‘neutral’ option, the two middle options of ‘somewhat agree’ and ‘somewhat disagree’ have inadvertently become the ‘neutral’ option. The terms ‘somewhat agree’ and ‘somewhat disagree’ can be interpreted to have the same meaning as when a glass is half full; it can also be interpreted as being half empty. The sample participants in the pilot test did have issues with these options.

If the ‘somewhat agree’ and ‘somewhat disagree’ options were considered the ‘neutral’ option and taken out of the equation, the questions that produced the highest neutral figures were on whether the board and CEO set annual Key Performance Indicators (KPI)s for the organisation using the organisation’s vision and mission, and the question on whether the board

evaluates the organisation's performance using the KPIs at least once a year. The result for the neutral option was 39.63 percent. This shows that only 60.37 percent of the participants could clearly agree or disagree that their KPIs were evaluated. The rest inadvertently fell into the 'neutral' option.

The third KPI question also produced a high neutral result, which is whether the board sets annual KPIs for the CEO based on its mission and vision and carries out an annual job appraisal. This question produced a neutral result of 39.62 percent which is only 0.01 percent below the other two KPI questions. There were only three KPI questions and all three of them produced a high result in the 'neutral' option.

The question that produced the lowest result in the 'neutral' option is whether the organisation had a whistleblower policy. The neutral option produced a result of 10.38 percent which means 89.62 percent of the participants choose to agree or disagree that they had a whistleblower policy.

### **iii) All levels of agreement and disagreement**

When all levels of agreements are added together, the question on whether the organisation has a clearly articulated mission and vision produced the highest result, which accounted for 98.11 percent. This has a corresponding effect on the total sum of all levels of disagreement, which adds up to 1.89 percent making it the lowest result for the disagreement options. Almost all the organisations have a vision and a mission, which is good for the sector as they know why they exist and the purpose of their activities.

The question with the lowest result for the agreement options was 'The organisation has a written policy on whistleblower protection'. This, too, has a corresponding effect on the sum total of all the levels of disagreement. The lowest result for all levels of agreement was 13.20 percent while the highest amount for all the levels of disagreement was 86.80 percent. Whistleblower protection may be the least of the CEOs worries especially because they are

many other matters more pressing in a small NFP organisation on a day-to-day basis.

Moving on from the 30 questions on corporate governance are questions on financial governance below.

#### **6.3.4 Financial governance practice**

Twenty financial governance questions were asked in this section. Like the corporate governance section, the financial governance questions also had six options, ranging from different degrees of agreement to different degrees of disagreement. Once again, the three levels of agreement are 'strongly agree', 'agree' and 'somewhat agree'.

Appendix I contains the results for all the twenty financial governance questions. The following is a descriptive analysis of these financial governance questions.

As mentioned in the previous section, the Likert scale was also used in these questions, and similarly, 0–33.33 percent responses will be considered low, 33.34–66.67 percent responses will be considered moderate and 66.68–100 percent responses will be considered high.

##### **i) Strongly agree and strongly disagree options**

Of the 20 questions on financial governance, only five questions produced a low 'strongly agree' response. The lowest response was for two specific questions. They are whether a new audit firm or a new CPA is appointed every five years. Only 4.72 percent participants chose 'strongly agree' to this question. Approximately 4.72 percent indicated that the board identifies for the auditor a different area of operation each year for a more in-depth audit analysis. The reason why the above two questions produced such low results could be because small NFP organisations are not required to carry out audits as per their reporting requirement mentioned in Chapter Two.

Only one question produced a high response. This question was whether signatories checked invoices before cheques were signed off according to their conflict of interest policy. Close to 67.92 percent of the organisations chose 'strongly agree' for this question. This result seems to contradict question 16 in the corporate governance section, where participants were asked if their organisation had a clearly articulated and transparent conflict of interest policy, and only a 40.57 percent of participants strongly agreed. However, when all the three levels of agreement are added together, the result is 80.19 percent affirmative. For that reason, the 67.92 percent of participants could comprise all levels of agreement in question 16 of the corporate governance section.

The results of the 'strongly disagree' options all fall below 15 percent except for five questions. The question that produced the highest result was whether the board identifies for the auditor a different area of operation each year for a more in-depth audit analysis. The question with the second highest result was whether a new audit firm or a new CPA is appointed every five years. Once again, the reason for such a high result of disagreement could be because small NFP organisations are not required to carry out an audit.

#### **ii) Neither agree and neither disagree options**

As mentioned in the previous section every effort had been taken to avoid a 'neutral' option. The effort seemed to have been futile, as the two middle options of 'somewhat agree' and 'somewhat disagree' have inadvertently become the 'neutral' option.

Like the above section, if the 'somewhat agree' and 'somewhat disagree' options were considered the 'neutral' option and taken out of the equation, the three questions that produced the highest neutral figures were:

(1) 'The organisation has a cash flow statement which is used to determine the financial standing of the organisations at any period'. This produced a result of 42.46 percent.

(2) 'The CEO has formal financial training', which produced a result of 39.62 percent.

(3) 'The organisation has a 3-year budget', which produced a result of 38.68 percent.

The three questions above seem to be linked because when the CEO does not have formal financial training, they may find it difficult to prepare financial control devices such as a budget and a cash flow statement.

The question that produced the lowest result in the 'neutral' option is whether the board identifies for the auditor a different area of operation each year for a more in-depth audit analysis. The neutral option produced a result of 3.77 percent which means 96.23 percent of the participants choose to strongly agree, agree, strongly disagree or disagree that the board performed the above task.

### **iii) All levels of agreement and disagreement**

When all levels of agreements are added together, the question on whether the organisation's financial documents are securely kept for at least seven years produces the highest result of 96.23 percent. This result has a corresponding effect on the total sum of all levels of disagreement, which adds up to a low 3.77 percent making it the lowest result for the disagreement options. The reason for this result could be that it was the Australian Taxation Office's requirement in the past that financial records for NFP organisations be kept for a term of seven years. This term has been dropped to five years (Australian Government, 2015).

The question with the lowest result for the agreement options is the last question in this financial governance section, which is whether the board identifies for the auditor a different area of operation each year for a more in-depth audit analysis. This, too, has a corresponding effect on the sum total of all the levels of disagreement. The lowest result for all levels of agreement is 11.32 percent while the highest amount for all the levels of disagreement is 88.67 percent. As mentioned above, the reason for such a low percentage of

agreement could be because small NFP organisations are not required to have their financial records audited.

Moving on from the descriptive analysis is the logistic regression analysis of the quantitative data.

#### **6.4 A logistic regression analysis**

Logistic regression is a type of statistical classification model. It is used to predict a binary response from a binary predictor (Hair, Black, Babin, Anderson, & Tatham, 2006). Logistic regression is limited to the binary dependent variable and predicts the odds of an event occurring based on the probability (Hair, et al., 2006).

Logistic regression is used to predict a dependent variable by using continuous independents and to determine the percent of variance in the dependent variable explained by the independent variables (Hosmer & Lemeshow, 2000). It is also used to rank the relative importance of independents, to determine interaction and to understand the effect of co-variables as control variables (Hosmer & Lemeshow, 2000). The impact of predictor variables is usually explained in terms of odds ratios. Logistic regression combines the independent variables to estimate the probability that a particular event will occur. It does not make any suppositions of normality, linearity and homogeneity of variance for the independent variables (Jaccard, 2001). The data that relates to all the variables were examined for accuracy and normality through the SPSS 17 program.

Since the research questions relate to the predictive power of a set of predictor variables, the logistic regression model was adopted to test the research hypotheses (Tabachnick & Fidell, 2001).

The hypotheses for this research are:

H1: Cash built up in an organisation has an impact on the statements related to corporate governance.

H2: The organisation on the verge of closing down has an impact on the

statements related to financial governance.

In the current research, the dependent variables were two performance statements that satisfied the logistic regression requirement (Tabachnick & Fidell, 2001). One question in the corporate governance section and another in the financial governance section have been identified as dependent variables.

Dependent variables:

DV 1=Over the past five years, the organisation has built up cash levels  
(CG30)

DV 2=The organisation has not been on the verge of closing down in the last five years (FG13).

According to the binary logistics model, the probabilities of 'cash built up in an organisation' and 'the organisation on the verge of closing down' having an effect on the demographic, corporate governance and financial governance statements can be modelled as a nonlinear function of the linear combination of main effects as,

Probability of cash built up in an organisation =  $e^Y/(1+e^Y)$

Probability of the organisation on the verge of closing down =  $e^Y/(1+e^Y)$

Where,

$$Y=b_0 + b_1X_1 + b_2X_2 + \dots + b_kX_k \dots \dots \dots (1)$$

And  $X_1, X_2, \dots, X_k$  are predictors, and  $b_1, b_2, \dots, b_k$  are the corresponding coefficients with  $b_0$  as the constant. The predictors represent the main effects of the hypothesised variables. This linear regression transforms to the following logit model,

Log (a cash built up in an organisation and the organisation on the verge of closing down) =

$$\beta_0 + \beta_1X_1 + \beta_2X_2 + \dots + \beta_kX_k \dots \dots \dots (2)$$

'Cash built up in an organisation' and 'the organisation on the verge of closing down' were hypothesised as a function of demographic characteristics, corporate and financial governance. Demographic characteristics include type and legal structure of organisation, age, gender and education level of CEO. The variable sets were entered into the logistic

regression in order to predict the performance and sustainability of the organisations. The dependent variables 'cash built up in an organisation' and 'the organisation on the verge of closing down' measure the performance and sustainability of the organisations. The probabilities of the Wald statistic and their Exp (B), representing the change in the odds of the modeled event, would predict the performance and sustainability of the organisations.

**Table 6.6 Hypotheses testing outcomes**

<b>Hypotheses</b>	<b>Results</b>
H1: Cash built up in an organisation has an impact on the statements related to the demographic characteristics, corporate governance and financial governance.	Partially supported
H2: The organisation on the verge of closing down has an impact on the statements related to the demographic characteristics, corporate governance and financial governance.	Partially supported

The two questions above show the performance of an organisation. Although the primary purpose of a NFP organisation is related to its service to the community and not to profit (Smith, 2001), a constantly built up cash level will act as a reserve for an unexpected drop in income, such as the withdrawal of a funding body or sponsor or a drop in internally generated funds or an increase in unforeseen expenses.

When the first dependent variable is tested against the independent variables, eleven statements show significance (Tabachnick & Fidell, 2001).

The statements that show positive significance are:

1. CG6 = Board vacancies are formally advertised and directors formally recruited.
2. CG10 = The organisation has a clearly articulated business plan.
3. CG15 = The directors are provided with all documents and details pertaining to an issue before they make a decision.
4. CG17 = The board evaluates the conflict of interest policy from time to time and ensures compliance.
5. CG18 = Agreements and contracts are read through before they are

signed to ensure they comply with the conflict of interest policy.

6. CG19 = Only directors on the board sign agreements and contracts on behalf of the organisation.
7. CG28 = Directors are provided with all relevant business papers at least a week before a board meeting.
8. CG29 = The organisation only carries out clearly defined core business in accordance with the mission, vision and business plan.
9. FG15= The organisation has an annual budget. This is used to check variances of budget figures to actual expenses.
- 10.FG17= The organisation has a cash flow statement that is used to determine the financial standing of the organisation at any period.
- 11.Demographic = CEO's educational level.

The discussion surrounding the significant statements is presented in detail in Chapter 8 which is the research discussion chapter. The logistic regression method is used to test for the effects of all independent variable sets in predicting the probability that each statement in a sample belongs to the dependent variable category coded 0 or 1. All predictions were therefore expressed in terms of probabilities, rather than actual scores (Cooksey, 2007).

Table 6.7 lists the significance values for the individual variable sets contributing to the prediction of the probability of belonging to the dependent variables. B contains the estimated regression weights for each predictor, the Wald statistic tests the regression coefficient and Exp (B) relates to the transformation of each regression weight into a statement of the odds.

**Table 6.7: CG30 as dependent variable**

	<b>B</b>	<b>S.E.</b>	<b>Wald</b>	<b>df</b>	<b>Sig.</b>	<b>Exp (B)</b>
CG1	0.496	0.483	1.056	1	0.304	0.609
CG2	1.121	0.868	1.667	1	0.197	3.068

CG3	0.434	0.796	0.297	1	0.586	1.544
CG4	0.196	0.531	0.137	1	0.712	0.822
CG5	1.064	0.658	2.619	1	0.106	2.899
CG6	0.704	0.357	3.901	1	0.048*	0.494
CG7	0.068	0.441	0.024	1	0.878	0.934
CG8	0.276	0.493	0.313	1	8.576	1.318
CG9	0.317	0.467	0.461	1	0.497	1.374
CG10	0.909	0.461	3.884	1	0.049*	0.403
CG11	0.109	0.472	0.053	1	0.818	1.115
CG12	0.050	0.241	0.043	1	0.836	1.051
CG13	0.044	0.281	0.025	1	0.875	0.957
CG14	0.436	0.365	1.429	1	0.232	0.646
CG15	1.162	0.443	6.877	1	0.009*	0.313
CG16	0.720	0.529	1.482	1	0.224	2.055
CG17	1.700	0.736	5.338	1	0.021*	0.183
CG18	1.447	0.589	6.041	1	0.014*	4.251
CG19	1.222	0.474	6.663	1	0.010*	0.295
CG20	0.385	0.504	0.583	1	0.445	0.681
CG21	0.324	0.316	1.053	1	0.305	0.723
CG22	0.286	0.549	0.271	1	0.602	0.751
CG23	0.452	0.21	0.752	1	0.386	1.572
CG24	0.268	0.707	0.143	1	0.705	1.307
CG25	0.150	1.186	0.016	1	0.899	1.162
CG26	1.325	1.209	1.202	1	0.273	0.266
CG27	0.248	0.524	0.224	1	0.636	0.780
CG28	2.330	0.813	8.210	1	0.004*	2.278
CG29	1.008	0.570	3.129	1	0.077*	0.365
FG1	0.139	0.330	0.177	1	0.674	1.149
FG2	0.205	0.450	0.207	1	0.649	1.227
FG3	0.471	0.287	2.687	1	0.101	1.601
FG4	0.387	0.710	0.297	1	0.586	0.679
FG5	0.312	0.948	0.108	1	0.742	0.732
FG6	0.941	0.587	2.570	1	0.109	2.563
FG7	0.463	0.586	0.624	1	0.430	0.603
FG8	0.269	0.395	0.464	1	0.496	1.309
FG9	0.396	0.283	1.968	1	0.161	0.673
FG10	0.474	0.542	0.764	1	0.382	1.606
FG11	0.951	0.593	0.025	1	0.873	0.910
FG12	0.414	0.470	0.776	1	0.378	1.513
FG13	0.823	0.478	2.970	1	0.085	2.277
FG14	0.225	0.411	0.299	1	0.585	1.234
FG15	0.896	0.561	2.552	1	0.001*	0.408
FG16	0.049	0.441	0.012	1	0.912	0.952
FG17	0.288	0.373	1.597	1	0.004*	1.334
FG18	1.023	0.888	1.328	1	0.249	0.360
FG19	1.485	1.040	2.039	1	0.153	4.317
FG20	0.345	4.148	3.651	1	0.056	2.418
Industry	0.009	0.095	1.002	1	0.924	0.991
Legal	0.110	0.335	1.108	1	0.743	0.896
CEO1	0.056	0.472	0.014	1	0.906	0.858
CEO2	0.043	0.477	0.024	2	0.210	0.653
CEO3	0.021	0.238	2.012	1	0.003*	0.223
Constant	-6.124	0.435	63.421	1	0.003	0.000

The standard error associated with the coefficients is used for testing whether the parameters are significantly different from zero, and for the formation of the confidence interval for the parameter. Degrees of freedom (df) are included for each of the tests of coefficients. The values presented in the significance column represent the probability of obtaining the Chi-square statistic given the stated null hypothesis is true.

The relative predictability of various variables included in the logistic regression can be assessed using three criteria: the increase or decrease in the -2 Log Likelihood, any changes in the size of the Cox & Snell R Square, and Nagelkerke R Square values (Hair, et al., 2006). For the -2 Log Likelihood, the number by itself does not offer much information; however, the -2 Log Likelihood values are deemed to be important in comparing the nested models. The Cox & Snell R Square and Nagelkerke R Square represent the pseudo R –squares (Gounaris & Koritos, 2008). Table 6.8 below is the summary of the corporate governance test.

**Table 6.8 Model summary for corporate governance**

Step	-2 Log Likelihood	Cox & Snell R Square	Nagelkerke R Square
1	264.701	0.280	0.408

The value for the Nagelkerke R Square is 0.408, thus predicting about 40 percent of the variability in probabilities for belonging to the category coded '1' for the CG30 variable. This value for the Nagelkerke R Square is statistically significant at  $p < 0.001$ . The classification accuracy criterion, is represented as the overall correct classification prediction rate. The -2 Log Likelihood value for the corporate governance variables is 264.701 and the estimation terminated at iteration number 20, as the parameter estimates changed by less than 0.001. The statements representing CG6, CG10, CG15, CG17, CG18, CG19, CG28, CG29, FG15, FG17 and the CEO's educational level showed significance, thus partially supporting the stated hypothesis partially.

When the second dependent variable, *The organisation has not been on the verge of closing down in the last five years (FG13)*, is tested against the independent variables, only two statements representing the CEO's educational level and the CEO's formal financial training showed significance.

It was not surprising that the CEO's educational level and financial training proved significant because many small NFP organisations depend heavily on the CEO for their success. In a small NFP organisation, when the CEO is an active person, the organisation follows suit and runs with many programs. If the CEO is mediocre, the organisation becomes an average performer. Small NFP organisations with limited staff and many volunteers take on the persona of the CEO. For that reason, when the statement on whether the organisation had been on the verge of closing down in the past five years was tested, it is the CEO's educational level and the CEO's formal financial training that showed significance.

Table 6.9 is presented below with significant statements noted with an asterisk. The questions that showed significance are:

1. FG 14 = The CEO has formal financial training
2. Demo = CEO's educational level

Once again, the discussion surrounding the significant statements is presented in detail in Chapter 8 which is the research discussion chapter.

**Table 6.9: FG13 as dependent variable**

	<b>B</b>	<b>S.E.</b>	<b>Wald</b>	<b>df</b>	<b>Sig.</b>	<b>Exp (B)</b>
CG1	1.234	0.394	2.132	1	1.203	0.054
CG2	1.587	0.023	1.658	1	0.367	3.345
CG3	0.324	0.122	0.976	1	1.203	1.549
CG4	1.482	0.245	3.182	1	0.549	0.328
CG5	1.763	0.642	1.324	1	0.102	2.976
CG6	2.305	0.764	3.991	1	1.230	3.403
CG7	1.298	0.972	0.710	1	1.981	0.768
CG8	0.564	0.257	0.713	1	3.232	1.815
CG9	0.244	0.875	0.912	1	0.754	1.399
CG10	1.280	0.972	2.488	1	0.376	0.054
CG11	1.244	0.345	0.782	1	0.844	2.128
CG12	1.502	1.235	2.453	1	1.806	3.567

CG13	0.324	1.302	0.298	1	0.698	0.975
CG14	0.304	0.765	1.236	1	0.522	0.455
CG15	2.132	0.498	5.912	1	0.901	0.867
CG16	0.823	0.982	1.432	1	0.992	2.765
CG17	2.342	0.120	4.377	1	0.645	0.970
CG18	0.342	1.232	3.966	1	1.654	4.287
CG19	1.723	0.474	2.623	1	0.321	0.223
CG20	0.645	1.456	1.807	1	0.442	2.744
CG21	1.284	1.265	1.759	1	0.477	0.653
CG22	1.763	0.284	0.675	1	0.934	0.543
CG23	1.232	0.419	0.236	1	1.232	1.822
CG24	1.023	0.707	2.634	1	0.992	1.754
CG25	0.976	1.183	0.932	1	0.386	1.299
CG26	1.872	1.382	3.281	1	1.270	1.265
CG27	1.756	0.875	0.663	1	0.496	0.344
CG28	2.232	0.765	6.865	1	0.894	1.195
CG29	1.876	0.256	3.902	1	0.223	0.365
CG30	1.296	0.332	1.442	1	0.789	0.167
FG1	0.286	0.457	0.873	1	0.324	0.328
FG2	0.123	0.654	1.632	1	0.403	2.304
FG3	0.765	0.876	0.299	1	0.993	1.232
FG4	1.264	0.433	0.193	1	0.876	1.325
FG5	0.123	1.234	2.294	1	0.187	1.563
FG6	0.654	0.832	0.755	1	0.333	0.876
FG7	0.435	1.297	1.742	1	0.365	2.379
FG8	0.277	0.432	1.287	1	0.277	0.543
FG9	0.876	0.432	0.993	1	0.343	2.398
FG10	1.286	0.876	1.987	1	0.386	1.201
FG11	1.444	0.343	1.324	1	0.432	2.453
FG12	0.834	1.235	2.257	1	0.582	4.892
FG14	1.224	0.456	1.432	1	0.012*	2.332
FG15	0.543	1.501	1.984	1	0.422	1.243
FG16	0.234	0.434	0.012	1	0.236	1.236
FG17	1.232	1.276	3.003	1	0.302	3.336
FG18	1.932	0.608	1.406	1	0.254	0.765
FG19	1.483	1.567	2.087	1	0.322	3.098
FG20	1.305	2.156	1.932	1	0.432	3.236
Industry	0.102	0.867	2.103	1	0.932	0.780
Legal	0.107	0.345	1.230	1	0.865	0.777
CEO1	0.063	1.234	1.872	1	0.355	0.435
CEO2	0.023	0.765	1.804	2	0.234	0.309
CEO3	0.059	0.634	1.222	1	0.013*	0.562
Constant	-3.425	1.168	18.594	1	0.005	0.033

Table 6.10 gives a summary of the financial governance testing.

**Table 6.10 Model summary for financial governance**

Step	-2 Log Likelihood	Cox & Snell R Square	Nagelkerke R Square
1	152.721	0.296	0.318

The value for the Nagelkerke R Square is 0.318, thus predicting about 32 percent of the variability in probabilities for belonging to the category coded '1' for the FG13 variable. This value for the Nagelkerke R Square is statistically significant at  $p < 0.001$ . The classification accuracy criterion is represented as the overall correct classification prediction rate. The -2 Log Likelihood value for the corporate governance variables is 152.721. The statements representing only FG14 and the CEO's educational level showed significance, thus partially supporting the stated hypothesis.

## **6.5 Conclusion**

The online survey was a quantitative research technique. This research technique was used because it had many advantages. The main advantage it offered this study was that it allowed the researcher the opportunity to reach a wider audience (Bachmann & Elfrink, 1996; Cooper & Schindler, 2003) including groups that are difficult to reach using other methods (Garton, et al., 1999; Wellman, 1997).

Reaching a wider audience was especially important for this research because a review of the literature showed that there has not been any research conducted to establish a corporate governance 'best practice' framework specifically for small NFP organisations not only in Australia, but anywhere else in the world. For that reason, it was important to reach the wider Australian NFP organisations.

When the results of the survey were analysed using SPSS 17 and a logistic regression analysis performed, it showed 11 significant statements in the corporate governance section and two significance statements in the financial governance section. One of the statements showed significance in both, the corporate governance and financial governance tests. For that reason, in total, there were only 12 statements that showed significance when the statement that showed significance in both the tests was counted only once. In an effort to validate this result, it was further tested using two

other lines of enquiry which are in-depth interviews and a case study. This is presented in the next chapter.

## **Chapter 7 Qualitative Results**

### **7.1 Introduction**

Qualitative research is a method of collecting subjective data from the participants through methods such as in-depth interviews, focus group discussions, observations, and content analysis (Hennink, Hutter, & Bailey, 2011). These research techniques examine participants' experiences in detail, their thoughts and their expectations (Boyce & Neale, 2006). Qualitative research is used when it is important to identify issues from the participants and to understand the meanings and interpretation that they give to behaviours, events and objects (Hennink, et al., 2011).

This method has become increasingly popular in the last few decades (Bryman & Burgess, 1994; Denzin, 1994; Jensen, 1991; Marshall & Rossman, 1999; Morse, 1994) and it is also rapidly becoming accepted to have a deeper understanding of issues (Attride-Stirling, 2001).

### **7.2 Analysis of qualitative data**

What is of concern to researchers is how to analyse the textual material that qualitative researchers gather (Attride-Stirling, 2001). According to Attride-Stirling (2001), if qualitative research is to provide significant and valuable results, it is imperative that data that has been collected are analysed in a methodical fashion.

Although there is literature devoted to specific qualitative research issues (Bryman & Burgess, 1994; Cresswell, 1997; Denzin & Lincoln, 1998; Feldman, 1995; Miles & Huberman, 1994), what is lacking are sophisticated tools to analyse the data that was gathered through research (Huberman & Miles, 1994), and greater disclosure in qualitative analysis (Attride-Stirling, 2001).

According to Attride-Stirling (2001), tools to analyse data that allow greater disclosure are recording, systematising and disclosing the methods of

analysis so that existing techniques can be shared and improved, allowing for improved tools to be developed. One analysis suggested by Attride-Stirling (2001) is the thematic analysis that is presented as *thematic networks*. *Thematic networks* are web-like *networks* that summarise the main *themes* constituting a piece of text (Attride-Stirling, 2001).

The above method of analysis has been forgone to allow the data to be analysed following Miles and Huberman's (1994) qualitative data analysis approach, which is the Thematic Matrix Analysis. Responses to question were grouped into themes of importance using Miles and Huberman's (1994) thematic matrix display analysis technique. This method of analysis provided conceptually clustered matrix displays to enable easy understanding of the meaning. (Miles & Huberman, 1994). It also brings together the unity of the concepts from similar responses provided by respondents (Langdridge, 2004). The qualitative data were analysed for thematically similar themes and then, grouped together.

### **7.3 Merits of in-depth interviews**

The main advantages of in-depth interviews and case study methods of qualitative research are that they provide much more detailed information than other data collection methods, such as online surveys (Boyce & Neale, 2006; Stevens, Lawrence, Sharp, & Frechtling, 1993). Interviewees may also feel more relaxed when the data are being collected making them feel more comfortable to provide information to the researcher (Boyce & Neale, 2006).

In-depth interviews and case studies also allow the interviewer to clarify questions. This increases the probability of obtaining useful data (Stevens et al., 1993). Stevens et al. (1993) say that the interviewer can collect greater data than written responses in that they are able to obtain affective as well as cognitive responses.

## 7.4 In-depth interview

### 7.4.1 Interview participants

As mentioned in the research methodology chapter, the in-depth interview is a qualitative research technique (Boyce & Neale, 2006). In this study, twelve small NFP organisations were invited to participate in an in-depth interview. Two of the organisations did not respond to the invitation, while the remaining ten organisations accepted the invitation, accounting for 83.33 percent of the total sample. The organisations were chosen at random from the ACNC register of NFP organisations. It is uncertain if any of the organisations participated in the online survey because the online survey was anonymous. Table 7.1 shows the demographic profile of the chairpersons and organisations that participated in the in-depth interviews.

**Table 7.1 Demographic profile of Chairpersons and organisations**

<b>Org</b>	<b>Industry of organisation</b>	<b>Chair-person</b>	<b>Accepted or refused invitation</b>
1	1 <sup>st</sup> Arts and culture	Female	Accepted invitation
2	2 <sup>nd</sup> Arts and culture	Male	Accepted invitation
3	Youth	Female	Accepted invitation
4	Early childhood	Female	Accepted invitation
5	Housing	Female	Accepted invitation
6	Land and property management	Male	Accepted invitation
7	Women support	Female	Accepted invitation
8	Library	Female	Accepted invitation
9	1 <sup>st</sup> Senior's group	Male	Accepted invitation
10	2 <sup>nd</sup> Senior's group	Female	Accepted invitation
	Medical centre	Female	Refused interview
	Private primary and preschool	Male	Refused interview

### 7.4.2 Interview questions

The questions were developed based on the online survey questions that showed significance when a logical regression analysis was carried out.

From the 12 questions that showed significance, as shown below, 17 broad questions were developed. These questions are shown in Appendix D. They were broken down to draw out more information from the participants. There were six questions on the Board of Directors' roles and responsibilities, five questions on financial management, three questions related to the policy and three questions on the CEO or senior management.

1. Board vacancies are formally advertised and directors formally recruited.
2. The organisation has a clearly articulated business plan.
3. The directors are provided with all documents and details pertaining to an issue before they make a decision.
4. The board evaluates the conflict of interest policy from time to time and ensures compliance.
5. Agreements and contracts are read through before they are signed according to the conflict of interest policy.
6. Only directors on the board sign agreements and contracts on behalf of the organisation.
7. Directors are provided with all relevant business papers at least a week before a board meeting.
8. The organisation only carries out clearly defined core business in accordance with the mission, vision and business plan.
9. The organisation has an annual budget. This is used to check variances of budgeted figures to actual expenses.
10. The organisation has a cash flow statement that is used to determine the financial standing of the organisation at any period.
11. CEO's educational level.
12. The CEO has formal financial training.

#### **7.4.3 Results that did not support the regression analysis**

The interviews did not disclose any irregularity in the practice of any of the organisations with regard to contract management. It seems that all the organisations only allowed board members and the CEO or the finance

officer to sign contracts. Board members also read through the contracts before signing them in all of the interviews conducted.

Making decisions at the board level was also not an issue. Board members in all the organisations were provided with business papers at least seven days prior to a meeting and decisions were made at board meetings collectively. The directors were provided with all documents and details pertaining to an issue before they were required to make a decision.

All the organisations only carried out their core business activities. The interview did not disclose any concerning practice in the organisations in the running of their programs or their activities.

The CEOs' formal financial training and educational level was not significant in the way the organisations were run. Some of the CEOs were not required to do any financial management, as those organisations had appointed a financial officer to do all the financial reporting. This way, the financial responsibilities were removed from the CEO. One of the CEOs was provided with ongoing financial training, especially in MYOB, which is an accounting software. Even then, the organisation appointed an administrative staff member to assist the CEO in the day-to-day financial management of the organisation. The Board of Directors seemed to understand their CEOs' strengths and support them in their weak areas, which seemed to be mostly in financial management. Since small NFP organisations do not have a large budget to invest in ongoing training, it seemed more appropriate and workable to appoint a support person to assist the CEO in the financial management aspect of the organisation.

All the organisations that participated in the interviews had either a conflict of interest policy or a conflict of interest register. A conflict of interest register is a book that is brought to board meetings where directors can register their conflicts of interest based on the agenda of the board meeting. This could be because of the new regulations and penalties introduced in the *Associations Incorporation Act 2009* (Council of Social Service of New South Wales,

2013). As mentioned in Chapter Two, directors may be imposed with a penalty of up to \$6600 if they neglect to disclose any conflict of interest between their own affairs and the affairs of the association (Council of Social Service of New South Wales, 2013). This new penalty may have motivated boards to have a conflict of interest policy or register.

#### **7.4.4 Results that supported the regression analysis**

The following results of the in-depth interviews support the results of the regression analysis. The interviews indicate that there is significance between the financial management of an organisation and its long-term sustainability.

##### **i) Financial controls**

When it came to having business documents, most of the organisations seem to have a business plan, a budget and a cash flow. The table below shows the break-down of the figures. One of the organisations had a cash flow but it was not used in the daily operation of the organisation. Instead, it was only used to show funding bodies that they had a cash flow statement for funding purposes. This could be because the CEO did not know the benefits of having a cash flow statement, or/and he or she did not know how to use it effectively.

**Table 7.2 Organisations' financial documents**

	<b>Org had one that was used regularly</b>	<b>Did not have one</b>	<b>Had one but did not use it</b>
<b>Business plan</b>	7	3	
<b>Budget</b>	9	1	
<b>Cash flow</b>	7	2	1

Of the ten organisations that were interviewed, 50 percent were on the verge of closing their services. None of the organisations that were closing down had ever operated on a deficit. They had financial documents to help them

manage business risks and monitor their income and expenses. Budgets and cash flows are financial control mechanisms. Of the ten organisations that were interviewed, nine of them had a budget that was used regularly to check variances in budgeted figures to actual expenses.

When funds were low and no income was being generated, the organisations decided to close their operation. The purpose of the budget and cash flow is to inform management when funds were depleting. For that reason, one can say that management was able to use these two financial control mechanisms effectively. However, seven of the organisations had a business plan. Business plans are meant to be used to provide strategic direction, manage risks and plan for continuous improvements. Although seven of the ten organisations had a business plan, five of them were closing down.

#### **ii) Financial standing**

Through the interviews, it was discovered that of the ten organisations that were interviewed, five were going to close down from one to three months of the interviews. The following list describes the financial standing of each of the ten organisations that were interviewed.

Organisation one: This is an arts and cultural organisation. It had run out of funds and was going to undergo voluntary wind-up a month after the interview. According to the chairperson, an extraordinary meeting was called to inform the members of their financial state. The members were asked to make a decision as to the way forward with the organisation. The members made a decision to wind-up their operation and transfer the assets to a company.

Organisation two: This organisation has had a varied career since it began. It was vibrant at times and at the verge of closing down at other times. At one point it nearly closed down, but stayed open only two days a week. About ten years ago, the board appointed a CEO with business acumen and management experience who was able to rebuild the organisation with the

board's direction. For the last ten years, they have been increasing their programs and building-up their cash reserves.

Organisation three: This organisation does not have enough funds to set aside cash reserves. Every year they manage to make ends meet but are unable to build on their programs or make other improvements.

Organisation four: This is an early childhood service. Due to differences amongst its directors, the organisation will be closing down. This will be discussed further, later in the chapter.

Organisation five: The directors of the fifth organisation that was interviewed made a conscious decision not to apply for further funds when their funding term came to an end. This was because the guidelines to apply for funds changed and this organisation was required to carry out additional activities that were not in their mission. They did not wish to partner with other organisations that could carry out those activities. The directors felt that their organisation was too small and the board did not have the skills that were required to tender for funds.

They decided to transfer their services to a larger organisation. This organisation did not build up their cash reserves and could not have operated without the funds that the grant would provide. This organisation had been operating for over 25 years. It started with the government providing the organisation funds to purchase ten houses that were to be rented to needy women and their families.

The organisational expenses such as salaries and house maintenance were paid for by government grants. During the life of the organisation, they were generating funds by collecting rent. According to the chairperson, the rental income was used to purchase new furniture for the houses. This was done over the 25 years that this particular chairperson was in the position.

The chairperson was under the impression that as a NFP organisation, they were not allowed to 'make a profit', as she felt that the government would not provide grants if they generated funds that were not spent. She had been the chairperson for the last 25 years of the organisation. She thought that as a NFP organisation, they were meant to operate on a break-even basis. For that reason, the organisation did not build up their cash reserves for an emergency or to cover them if they were unsuccessful in their grant application.

Organisation six: The chairperson of this organisation spoke about how the organisation had closed its services on two occasions. This was not because it was lacking in funds, but more because of a dysfunctional board. The board matter will be discussed later in this chapter.

Organisation seven: This organisation is a women's organisation. Their main funding body had changed the funding guidelines. The board felt that the new guidelines were not in line with the organisation's mission and, for that reason, they decided not to apply for the funds. They had not built up their cash reserves and did not have any funds set aside. The board decided to close the organisation down because they decided not to apply for funds through their main funding body and did not discuss applying for funds through another source.

Organisation eight: This is a small library in a regional town. It was on the verge of closing down a few years ago because they did not have funds to continue operation. The board tried to obtain funds in a variety of ways to keep its services open to the community. When all their efforts failed, as a last attempt they approached the Member of Parliament (MP) in their electorate to assist. The MP was able to get a government department to fund them on a yearly basis.

Organisation nine: The organisation almost closed down because the board had overspent their funds. The board was not using the funds for the purpose allocated in the funding agreement or the budget.

Organisation ten: This is a senior's group that used to meet on a monthly basis. However, in the last three years, their funds were reducing and they were unable to raise any more funds. For that reason, they were closing down their operation in the new year, which was two months after the interview. Table 7.3 sums up in brief the financial state of each of the organisations.

**Table 7.3 Financial state of the organisations**

<b>Org</b>	<b>Industry of organisation</b>	<b>Financial background</b>
<b>1</b>	1 <sup>st</sup> Arts and culture	Closing down
<b>2</b>	2 <sup>nd</sup> Arts and culture	On the verge of closing down once before
<b>3</b>	Youth	Only making ends meet
<b>4</b>	Early childhood	Closing down
<b>5</b>	Housing	Closing down
<b>6</b>	Land and property management	Closed down on two occasions
<b>7</b>	Women support	Closing down
<b>8</b>	Library	On the verge of closing down once before
<b>9</b>	1 <sup>st</sup> Senior's group	On the verge of closing down once before
<b>10</b>	2 <sup>nd</sup> Senior's group	Closing down

Through a phone conversation, the researcher discovered that the two organisations that were invited to participate in the interview but did not respond to the invitation were in a critical financial state. One organisation closed their services within months of the invitation due to lack of funds and mismanagement, while the second organisation's board and business manager were dismissed by the funding body. An administrator was appointed to manage their finances and bring the organisation back into a

stable financial position. Table 7.4 below, shows the ten organisations' cash reserves.

**Table 7.4 The organisations' cash reserves**

<b>Current situation</b>	<b>Number of organisations</b>
Never had financial problems and do not have any cash reserves	1
Had financial problems and nearly closed down but now started building cash levels	4
Have financial problems and are closing down. Do not have any cash reserves.	4
Closing down, no cash reserves. Closing not because of financial problems.	1

### **iii) Board vacancies**

When asked if board vacancies are formally advertised and directors formally recruited, of the ten organisations that participated in this in-depth interview, eight chairpersons said that they elected their board at an Annual General Meeting (AGM), and two said that they informed the public through word-of-mouth and appointed appropriate people when they thought they were suitable.

Of the eight that elected their board at an AGM, seven of them felt that it was not a successful method of recruiting people. Of the two who appointed board members, one said that it was not successful as they have had 'rogue' directors. This meant that out of ten organisations that participated in the in-depth interviews, eight of the organisations did not have a successful method of recruiting directors. The following is a break-down of some of the board recruitment problems that the organisations faced. The following

organisations were chosen to be discussed below because they concerned the quality of the directors and their level of skills.

Organisation one: The chairperson felt that the directors were inexperienced and lacked sufficient business acumen to make strategic decisions. Most of the directors did not know how to read financial reports and the organisation had to constantly send them for financial training to understand financial reports. This took much of the organisation's annual budget.

The chairperson also felt that some people were just not suitable to be on any boards. They do not have the skills to contribute towards the Board's discussions. Even if directors had the best of intentions, it was not useful to have them on the board if they were not quick in making business decisions, because they did not understand the business matter and strategic intent of the organisation being discussed.

The chairperson felt that a two-tier board was a better solution. One board could be made up of business people and they could be responsible for governance, finance and business decisions. The second board could be made up of community members and it could be in charge of programs.

Organisation two: The chairperson of the second organisation felt that their recruitment method was not successful. Whenever directors were elected at an AGM, they had to 'hope for the best'. Very often they ended up with directors who did not know how to read financial reports and did not have the skills or the understanding to be on a board.

This organisation also had problems with directors who revealed board discussions to community members. Some board members also spoke about board matters to family members who were employed as staff. To overcome this problem, the organisation introduced a 'confidentiality deed'. Directors had to not only sign the deed, but they also had to get a witness to register that the director had read and signed the deed. This demonstrated to the directors that the organisation was serious about confidentiality and that it

was a legal document that would be used if needed. Some of the directors resigned when they had to sign the confidentiality deed.

Organisation four: Even though this particular organisation had a code of conduct, the directors still misbehaved. For that reason the chairperson said, “A code of conduct is as good as your ability to implement it”. She said that the wording for the code was important, as they should not have ‘motherhood statements’. She went on to explain that by ‘motherhood statements’, she meant that the wordings should not be easily misconstrued and must clearly state what directors can and cannot do.

Organisation six: On the two occasions when the organisation had closed its services, the boards were dismissed and the community lost that service. The boards on both these occasions were dysfunctional. There was in-fighting, aggressive behaviour at board meetings and conflict of interests.

The organisation reopened a few years ago and they now have a good board. They introduced a code of conduct for directors. Directors are now required to conduct themselves according to the code within and outside the organisation. If directors were found to be breaching the code, they were suspended and, in some cases, their membership was cancelled.

Organisation seven: The chairperson of this organisation said that they ask suitable people in the community to be on the board. Their current board consists of a solicitor, a university employee, a church worker and a university student. The chairperson said that they have had ‘rogues’ as directors who did not act in the best interests of the organisation. They attended an AGM and stacked the votes to get on the board. They had a conflict of interest and did not declare the conflict. They got on the board to support two employees who were their friends. In the end, the rest of the directors collectively dismissed the ‘rogue’ directors.

Organisation nine: The chairperson said that their organisation went to “hell and back” before he took over. As mentioned before, the organisation almost

closed down because the board had overspent their funds. The directors were also micro-managing the employees and the employee turnaround was high. Clients were very unhappy because the activities they requested were not being delivered and they started leaving this service. The directors did not know how to read financial reports and did not adhere to their main funding agreement.

This organisation had a good story to tell so they were invited to be a case study. The problems above will be explained in greater detail in the case study below.

#### **iv) Suggestions for a code of conduct**

The following table consists of suggestions made by the ten chairpersons on what was needed to be included in the code of conduct for directors.

**Table 7.5 Code of Conduct suggestions**

<b>Suggestions</b>	<b>Number of organisations that requested this</b>	<b>Comments</b>
Confidentiality	5	Directors who had family members employed in the organisation disclosed board discussions to their family members.
Corporate governance training	10	Training in understanding financial reports required.
Transparency	2	When transparency was discussed with each of the chairpersons, they felt that board decisions can be disclosed to members in the spirit of transparency, but board discussions should be kept confidential.

How to conduct oneself at meetings	5	There was lack of respect and directors were aggressive at board meetings. They demonstrated little respect for the other directors.
Making public comments	1	One director went to the media about a problem in the organisation without the consent of other directors.
Understanding the difference between management and governance	3	Directors must not interfere with the everyday running of the organisation.
Conflict of interest	10	Each one of the chairpersons felt that a conflict of interest policy should be part of any code of conduct for directors.
Special requirements	2	Must conduct themselves according to the code inside and outside the organisation.
Consequences	3	There must be consequences for their bad conduct.

#### **v) Assistance from the government**

When the organisations were asked what type of corporate governance assistance they need from the government, the answers could be put into four categories. They are board responsibilities, business development matters, financial governance and conducting board meetings.

Most of the chairpersons felt that a complete corporate governance training that includes the importance of confidentiality and declaring conflicts of interest was necessary. They felt that directors should be informed of the difference between governance and management and the board's role as

directors. It was also suggested that directors be informed of their fiduciary responsibilities. One chairperson suggested that directors be informed of the Independent Commission Against Corruption (ICAC) and their powers.

A few of the chairpersons felt that directors must know and understand business development discussions. They must have the ability to make clever business decisions. It was also important that directors be knowledgeable on how to create new businesses and how to move businesses forward.

The third type of support the chairpersons want from the government is training on reading and understanding financial reports. They said that they want financial training on a continuous basis. A few of the chairpersons felt that all directors must have enough skills to read board business papers and raise issues.

There is a NFP organisation called Financial Literacy Australia Limited (FLA), which funds other organisations that could help the community or community organisations with financial literacy (Financial Literacy Australia, 2012). FLA was founded in 2012 by members of the government's Financial Literacy Board. Its mission is to advance financial literacy in Australia. They encourage co-operation between corporate, government, community and education sectors within the financial literacy community. The FLA grants program supports not-for-profit organisations to advance financial literacy in Australia. In 2015, FLA expects to allocate up to \$1.4 million in grants (Financial Literacy Australia, 2012).

The last training that the chairpersons felt that the government could assist small NFP organisations with was on how to hold a board meeting. This would include roles and responsibilities. Board behaviour at meetings and how to manage conflicts was also raised as a possible training for directors.

## **7.5 Case study**

Of the ten organisations that were invited to participate in an in-depth interview, one was invited back to be a case study. As only CEOs were invited to take part in the online survey and chairpersons were invited to participate in the in-depth interview, the case study was to consolidate information from both the research techniques. For that reason, the chairperson and the CEO were invited to take part in the case study. The case study interview questions can be seen in Appendix J.

The purpose of the case study was to investigate the organisation's corporate governance and financial management practices, problems and solutions. This particular organisation was chosen because they had a story to tell. They had a board that was very dysfunctional to the point that they began to lose clients, were not able to retain senior staff and were running out of funds. The directors eventually were not re-elected and now they have a Chairperson who understands the importance of good governance, separation of management and governance and works well with management.

This organisation is a small NFP organisation that was receiving funds from a government department. Similar organisations receiving the same funding and providing the same service for similar clients were available in other towns.

The organisation being studied had difficulty retaining a CEO. In a span of five years they had five CEOs resign. News got to other similar organisations that they were once again looking to recruit a CEO. A staff member of a similar organisation in Inverell, who was familiar with the job, applied for the position. She had worked in the Inverell-based organisation for over three years and was very successful in her job. She applied for the position, was interviewed and recruited.

The new CEO then expected to receive an orientation, but this did not occur. She then requested to speak to the chairperson. She asked for an

orientation, a budget and a policy manual but was told that there was no orientation, budget or policy manual for the organisation. She began to draft policy documents for a new policy and procedures manual. She was sternly admonished for doing so. Her policy and procedures manual was shelved.

A few of the directors were volunteers who were working with the clients and a few were clients as well. The directors who were volunteers began to pressure the CEO to create programs that interested them rather than the clients. At one time, the chairperson said to the CEO, "You will do as I say because I am the chairperson". The CEO felt that she was caught between the clients who were requesting particular activities and the chairperson who wanted different activities.

Clients began to leave the organisation to other service providers. This affected their numbers and their KPIs. The clients were leaving not only because the activities did not interest them, but also because they began to feel that something was wrong in the organisation. The clients' departure became noticeable as they left in big numbers. The CEO then began to receive phone enquiries from other organisations wanting to know why they were losing clients. The CEO had come from an organisation where the board members were retired business people with business acumen. They were neither volunteers nor clients. Volunteers had specific tasks to do, while staff went on with the operation of the organisation and the board carried out governance responsibilities.

In this organisation, the directors did not understand their role. Instead of overseeing the work of the CEO, they began to micro-manage the staff. Board members constantly interfered with management matters. Their constant interferences did not allow the employees to do the work they were paid to do. A few of the directors were taking parts of the staff members' jobs away instead of understanding what needed to be done and providing support to the staff. They did not understand reporting lines and how they worked.

The CEO also noticed that the directors did not adhere to the funding agreement. Allocated funds for specific purposes were used to purchase things that the funds were not allocated for. Funds were overspent. Directors took the cheque book with them when they went shopping to purchase items that they thought the organisation needed without first consulting with the CEO.

In most organisations, all enquiries and correspondences are addressed to the office of the organisation. In this case, the directors took the organisation's correspondences home. Funding agreements were kept with the chairperson in his personal residence and information was not filtering through the office.

The board also had serious issues with confidentiality. For that reason, the CEO organised confidentiality training for all directors, but on the day of the training, the directors who needed it the most did not turn up. They also made public comments about the staff and new directors. The CEO felt that the directors should be bound by confidentiality while in office and after they leave the board.

The board was also not open and transparent in their dealings. Email correspondences were circulated to a select few directors and decisions were made through email correspondences without the knowledge of the other directors. Those directors who did not have emails were constantly excluded from the decision-making process. The decisions were later written into the minutes although that matter was not discussed at that particular meeting. Minutes were not true accounts of meetings. Some minutes were signed off while others were not. Some minutes were kept in the office while others were not.

According to the current chairperson and CEO, the directors did not show leadership. The board did not have strategic planning days. The organisation's financial reports were not tabled at board meetings and the directors did not know how to read financial reports. Due to their lack of

financial skills, the board did not discuss the financial standing of the organisation in relation to its strategic direction.

The CEO went on to speak about the director's behaviour during board meetings. She said that the directors argued about every matter on the agenda. They seemed to have no respect for each other and they were highly emotional when discussing issues. Personal self-interests took over the organisation's interests. The CEO felt that the directors lacked professionalism. When they voted on an issue, there were times when the chairperson asked the directors who voted differently to him to change their vote.

The above situation changed when new directors and a new chairperson were elected at their AGM two years ago. The new board went through the past minutes to see what policies were passed at the board meetings but discovered poor recording of minutes. They were unable to obtain full records of discussions and decisions that were made. Some of the minutes were missing. The new board then had to start from the beginning by making decisions at board meetings and passing policies. These policies were then kept in a policies and procedures manual.

The new Board of Directors and the CEO prepared an overall budget for the organisation. The directors also started to curb spending and kept to the budget stipulated by the funding agreement within the bigger budget of the organisation. They started charging a small fee for the services they provided and their cash reserves began to grow. Currently they have a small reserve of under \$5000 that has been kept aside for emergencies.

The new board allowed the CEO to consult clients on what activities interested them and prepared a one-year program for the organisation. This program was passed at a board meeting. Whenever the CEO wanted to trial a new activity, the board discussed it, and most of the time it was allowed on a trial basis. When the trial period was over, the board evaluated the

responses and allowed it to be added to the organisation's program if the activity was well received by the clients.

The corporate governance issues in this case study will be discussed in the next chapter. There are also some codes of conduct implications that will be discussed in the next chapter when all lines of enquiries for the research are consolidated.

## **7.6 Conclusion**

This chapter presents the results of the qualitative research, which are the ten in-depth interviews and the case study. All discussions regarding the qualitative research are in the next chapter.

One of the main aims of the qualitative research was to see if there are good governance practices, including financial management mechanisms. The in-depth interviews demonstrate that 50 percent of the small NFP organisations that were interviewed were going to close their services within months of the interview. This reaffirms the grass-root level perception and the very purpose for which this study was started.

Two of the organisations were closing down because they had run out of funds. Two of the organisations were closing down because their boards made a conscious decision not to apply for further funds so that they could wind-up and the last organisation was closing down because of conflicts amongst members of the board.

The qualitative data collection shows many problematic practices and behaviours in the small NFP sector. Some of them displayed conduct that parallels criminal behaviour such as intimidation, harassment, mismanagement of funds and other corrupt practices, such as putting pressure on directors to change their vote and manipulating with corporate records.

The ten in-depth interviews and the case study clearly demonstrate a need for better corporate governance practice in the small NFP sector. This could be done by introducing best practice guidelines and a code of conduct for directors.

## Chapter 8: Research Discussion

### 8.1 Introduction

The purpose of this chapter is to summarise and discuss the conclusions drawn from the results of this study. It brings together the four lines of enquiry that include both quantitative and qualitative research. It starts with a discussion on this mixed-methods research and how the literature review, online survey, in-depth interviews and the case study are consolidated. There are also discussions on each of the data collection methods.

Like all research, a literature review had to be conducted to determine the key issues and themes. After the literature was reviewed four research questions emerged which were then investigated. Through this study and appropriate data analysis techniques, these research questions were answered. They are discussed below in greater detail.

### 8.2 Research discourse

#### 8.2.1 Mixed-method research

As mentioned in the research methodology chapter, a mixed-method research approach is used in this study for triangulation, complementary, development and expansion (Bryman, 2006; Greene, et al., 1989; Niglas, 2004). Firstly, it was used for the purpose of *triangulation*. By this, questions that produced significant results in the online survey were extracted and used in the in-depth interview to confirm the result of the survey.

Secondly, in-depth interviews and a case study were carried out to *complement* the results from the online survey. Thirdly, a mixed-method research approach was used for *development purpose*. Qualitative research was carried out to further develop the quantitative research results. The purpose was to probe a small group of participants to get a deeper understanding of the initial results. Lastly, this research approach was

employed for the purpose of *expansion*, which is to illicit further information that would expand results from the online survey.

### **8.2.2 The mixed-method research results**

The first line of enquiry was a literature review. Six significant models of 'best practice' were chosen with a focus on corporate governance. From the literature review, a literature-informed proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia was developed. Twenty-one 'best practice' statements were recommended.

The literature review was used as the first line of enquiry because the literature disclosed that there are no corporate governance models of best practice for small NFP organisations in any country. Without literature providing instruction, significant studies and 'best practice' models developed for NFP organisations of varied sizes and FP organisations were used to develop the research framework.

The 21 literature-informed 'best practice' statements were converted into an online questionnaire. Fifty-five questions on corporate governance and financial governance were developed for the second line of enquiry, which was an online survey.

After the online survey data was collected, it was analysed using SPSS 17. When the 55 questions were run through the logistic regression analysis, 13 statements that were related to demographic, corporate governance and financial governance sections revealed significance. One of the significant statements was repeated in the financial governance test. When that statement was counted only once, the total significance statements dropped to 12. This result demonstrates that Hypothesis 1 and Hypothesis 2 were partially supported by the results. These 12 questions were then expanded to extract more information from the participants for the third line of enquiry, which were the in-depth interviews. The questions asked as part of the in-depth interviews are presented in Appendix D.

The ten in-depth interview results were then analysed following Miles and Huberman's (1994) qualitative data analysis approach, which is the Thematic Matrix Analysis. The results that showed that the online survey data analysis which were reliable were kept, while those that did not confirm the results were discarded. This then became the Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia. This can be found in Section 8.3.2 below.

There was also some information relating to the code of conduct data collected at the interviews. These data were kept aside until a case study was completed.

One of the ten in-depth interview participants were recalled for a case study because that small NFP organisation had undergone a difficult time with a Board of Directors who mismanaged funds, micro-managed staff and held their interest, above the interests of the organisation. The members then chose not to re-elect the board and elected new directors who then turned the organisation around.

The case study was the fourth line of enquiry. The code of conduct implications of the case study were added to the code of conduct data collected at the ten in-depth interviews. This then was used to construct a Proposed Code of Conduct for Directors of Small NFP Organisations in Australia. The purpose was to strengthen governance and provide greater stability to this section of the NFP sector.

### **8.3 Corporate governance model of best practice discourses**

#### **8.3.1 Corporate governance issues emerging from the in-depth interviews and case study**

The following sections discuss issues that were raised in the quantitative research. The issues that emerged were discussed in Chapter Two, where background information about the NFP sector was discussed, or in the literature review chapter.

### **i) Governance models**

The literature review revealed that the policy model and entrepreneurial model are appropriate governance models for small NFP organisations. In the policy model, the board provides leadership in the direction that the organisation will be taking (Carver, 2006). They then empower the CEO to implement the organisation's goals through staff or volunteers (Bradshaw, et al., 1998). Since many small NFP organisations have a limited budget, they have to work with volunteers. In Australia, the volunteer workforce in NFP organisations was 4.6 million in 2006–07, with a wage equivalent of \$14.6 billion (Productivity Commission, 2010). For that reason, this model is appropriate for them.

Moreover, small NFP organisations work with a small team of possibly a CEO, a staff member and a few volunteers. It would be easy for directors to get involved in management matters instead of only dealing with governance affairs. In the policy model, there is a clear separation of roles and clear line of authority (Marx & Davis, 2012a). This was an issue for organisations one and nine.

In the case study, there was a blurring of roles and responsibilities as some directors were also volunteers who worked with clients. This situation is further confused when a few directors were clients as well. It would have been difficult for the directors to know when they were acting in their role as a director and when they were acting in their role as a volunteer or client. One of the proposed 'best practice' guidelines is to avoid a conflict of interest (Boyce, et al., 2007; Cain, 2008). When there is a blurring of roles and the possibility of conflicts of interest, the directors should have resigned from the board, because declaring the conflict was not going to resolve this complicated situation of directors being volunteers and clients.

Another governance model that is appropriate for small NFP organisations is the entrepreneurial model. Its focus is on innovation, efficiency, effectiveness measures and a market orientation to find opportunities and competitive

advantages. Within this framework, plans are driven by annual short-term and three to five year longer-term plans (Bradshaw et al., 1998).

All the organisations that participated in the in-depth interviews use the policy model and look to the board for leadership. When leadership is lacking or failing it impacts on the organisation. The Chairpersons of the two Arts and Cultural organisations felt that there is a need for their organisation to be more business-like. The chairperson of the first Arts and Cultural organisation felt that there is a need for directors with knowledge on business development to be on the board, while the board of the second organisation appointed a CEO with business acumen and has seen the organisation grow financially and in its programs. This is more reflective of the entrepreneurial model.

#### **ii) Financial knowledge**

As mentioned in Chapter One, financial growth can accelerate the economic growth of any organisation (Beck et al., 2000). In a small NFP organisation where funds are insufficient to appoint a financial advisor or an investment consultant, the directors must have financial knowledge and business acumen. Therefore, directors must know how to read a financial report and how to interpret it. Directors with financial knowledge can ensure that the small NFP organisation has economic growth. By doing so, they can enhance savings, invest wisely and channel funds into more productive programs (Beck et al., 2000).

#### **iii) Transparency and accountability**

There has been growing calls for transparency and accountability, especially in the area of finance (Productivity Commission, 2010). Donors and sponsors are calling on NFP organisations to show evidence of program effectiveness.

One of the proposed 'best practice' guidelines mentioned in Chapter Three is that there is a distribution of periodic fiscal reports (Moyers, 2012). The board

discussed in the case study did not table their financial reports at any of their board meetings.

In the small NFP organisation, in the case study, directors took the organisation's cheque book and purchased goods that were not needed by the organisation without consulting the CEO. This behaviour is problematic. In a large NFP organisation, administering bodies, such as NSW Fair Trading or ASIC, require them to carry out an audit, which would have disclosed the ongoing random purchases not allowed within the budget. In a small NFP organisation, audits are not required by their administering bodies. This type of behavior, if undiscovered, then becomes a real issue for the survival of the organisation.

#### **iv) Self-regulated model**

According to the Productivity Commission (2010), funding bodies are known to impose compliance costs without commensurate benefits. They also lack the sense of proportion with regard to the size of organisation and the scale of the undertaking (Productivity Commission, 2010). For a small NFP organisation with limited trained staff and many volunteers, the organisation draws funds from needed programs to channel towards the compliance cost. For that reason a self-regulated model that is used in other countries (Bies, 2010; Guet, 2002) would be more appropriate for a small NFP organisation with limited funds.

#### **v) Leadership**

In a small NFP organisation, it can become easy for management to start running different activities and spreading their workforce thin in an effort to create more income streams. With limited funds and often being in a precarious state between survival and extinction (Suhood, 2001), a small NFP organisation must be clear with its mission, vision, activities, beneficiaries and long-term objectives (Boyce et al., 2007; Marx & Davis, 2012a). This will direct the CEO, staff and volunteers towards what programs to run within their mission.

The lack of clear direction was evident in organisations four, nine and ten. In the case study, which was organisation nine, the Board of Directors' lack of strategic planning affected the organisation, as the CEO was lost in the process of running the organisation, preparing the policy manual and not having undergone an induction. The board was unable to lead the organisation strategically.

Policies and procedures work as rules within an organisation so that there is a standard practice in all matters. General policy decisions are the responsibility of the board, along with the creation of a strategic plan for the centre, and the establishment of methods of implementing the plan and evaluating this implementation. That is why a review of the literature shows that there is a need for policies such as a whistleblower policy (Boyce et al., 2007), conflict of interest policy (Boyce et al., 2007; Cain, 2008) and records retention policy (Boyce et al., 2007).

In the case study, the directors showed a lack of respect for staff when they dismissed their initiatives. This can be very de-motivating for individual staff members. This was evident when the new CEO's effort to write a policies and procedures manual was set aside. The board lacked the skills to oversee the performance of the CEO and carry out appraisals. The board should have allowed the CEO to do her job and then actively engage in formal evaluation, which was another proposed 'best practice' guidelines (Marx & Davis, 2012a).

#### **vi) Trust**

In the case study, the directors should not have been involved in the planning of the activities. Clients were not benefiting from the service and for that reason they were leaving to go to other service providers. They also lost trust in the running of the organisation. According to the literature, trust is a big component of anyone's commitment to a NFP organisation.

This was very concerning for the CEO, because she had to complete funding acquittals where she had to indicate what key performance indicators (KPIs) were met. Clients leaving the organisation affected their KPIs, which were set by the funding body. If KPIs are not met, there is a possibility that further funding will be stopped and funds that have already been provided for projects may need to be returned. This will adversely affect the viability of the organisation and eventually its sustainability.

In a small NFP organisation where there may only be a CEO and a small staff, a domineering board is able to bully management into doing what they want to be done. This is less possible in a large NFP organisation with a large team of employees.

In the case study, when the clients felt that something was wrong with the organisation and decided to leave, it showed that they had lost trust in the organisation. The review of the literature shows that some of this activity is driven by a universal expectation of accountability, which includes the need for financial transparency and increased board governance, which would result in a demonstration of sectoral existence and sustainability (Harrow, 2006; Svitkova & Ortmann, 2006). For that reason, when discussing a small NFP organisation's sustainability, the issue of trust plays an important role.

All the discussions above have been taken into consideration when deciding on the final Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia, which is listed in Section 8.3.2.

### **8.3.2 Proposed Corporate Governance Model of Best Practice for Small Not-for-profit Organisations in Australia**

Twenty-one 'best practice' statements were proposed in the research methodology chapter. They were developed after the first line of enquiry, which was a literature review where models of corporate governance best practice were investigated and evaluated for their appropriateness for small NFP organisations in Australia.

Some of the statements did not prove to be significant in the quantitative research. These statements are omitted from the final proposal. The first of these non-significant statements is about NFP organisations having an authority to fundraise before they engage in fundraising activities.

The second statement is that a small NFP organisation must ensure that reasonable payments are made for services. This is another statement that did not show that it was significant when the result was analysed by SPSS 17.

Other statements that also did not show any significance are that a small NFP organisation must have three to seven members, key employees' remuneration must be reviewed annually, directors must be open to discussing issues, and directors must be provided written and oral forms of communication, such as board papers with sufficient time to review.

Moving on from proposals that were dropped from the final proposal for a corporate governance model of best practice are a few statements that have been consolidated into one proposal. These are statements about different policies that a small NFP organisation must have: investment, document retention, conflict of interest and protection for whistleblowers. These policies have been consolidated into 'Small NFP organisations must have a policies and procedures manual'.

Another two statements have been consolidated into one, are that a small NFP organisation must adopt its following year's program at a board meeting and a Board of Directors of a small NFP organisation must actively engage in formal evaluation. These two proposals have been consolidated into, A Board of Directors of a small NFP organisation must actively engage in formal evaluation of the programs, organisation and CEO performance'.

One statement that is very important will be added to the Proposed Corporate Governance Model of Best Practice for Small NFP Organisations

in Australia. It is, 'All directors of small NFP organisations in Australia must understand and know how to interpret a financial report'.

The following statements are now the final Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia:

1. A small NFP organisation must have a well-structured governance relationship between the board and the CEO.
2. A Board of Directors of a small NFP organisation must actively engage in formal evaluation of its program, organisation and CEO performance.
3. A small NFP organisation must have an effective board member recruitment and orientation process.
4. A small NFP organisation must have a mission statement that includes its mission, vision, activities, beneficiaries and long-term objectives.
5. A Board of Directors of a small NFP organisation must exercise due diligence by being fully informed of matters pertaining to transactions when reviewing them.
6. A small NFP organisation must demonstrate transparency in all its operations and demonstrate this transparency by registering its organisation at the ACNC portal.
7. A small NFP organisation must have their books reviewed by an independent CPA every year. A new CPA must be appointed every five years.
8. A Board of Directors of small NFP organisations must ensure that financial reports are provided to them regularly and that they have the ability to interpret them.
9. A small NFP organisation must meet its disclosure deadlines.
10. Directors on small NFP boards must be independent of each other and with the management in relations and in spirit.

The above is the final Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia. The following section

discusses the development of the Code of Conduct for Directors of Small NFP Organisations in Australia.

## **8.4 Code of conduct discourses**

### **8.4.1 Code of conduct issues emerging from the in-depth interviews and case study**

The following sections discuss issues that rose in the qualitative data collection. Like the corporate governance best practice section above, the code of conduct issues that emerged from the in-depth interviews and case study were discussed in the chapter about the NFP sector or in the literature review chapter.

#### **i) Transparency versus confidentiality**

Transparency was considered an important aspect of a code of conduct by all the chairpersons interviewed. Although they felt transparency was important and the board should disclose decisions made at board meetings to their members, detailed discussions and sensitive issues should be kept confidential.

In any size organisation, board discussions must be kept confidential. This was especially important in a small NFP organisation because a director could be an operational volunteer, may have a relative who is an employee, or could be a client of the organisation. This situation was evident in the ten in-depth interviews carried out.

In the case study, the CEO and chairperson of the organisation that was the subject of the case study felt that confidentiality was also important because a few of the former directors discussed detailed board matters with their friends outside of the organisation. It was not only unprofessional, but also unethical, because people being discussed could be defamed and the issues taken out of context.

## **ii) Respect**

Respect was a key element in small NFP organisations because of the closeness of its operation with the community. Respecting other directors and working as a team for the organisation instead of the individual's benefit was an issue that was raised through the qualitative data collection. A small NFP organisation needs a small group of focused directors who are aware of the organisation's mission, vision and objectives.

In a small NFP organisation without layers of management, the board's behaviour can become evident amongst everyone involved. There were cases in the data where some of the directors did not conduct themselves well at meetings. There was lack of respect for other directors at board meetings, and some of the directors were aggressive and raised their voice to prove a point. They demonstrated little respect for the other directors.

The directors in the case study were argumentative at board meetings. This behaviour was not constructive. They should have used a democratic method to resolve issues. One of the directors could have moved a motion and voted on the motion. Instead, they used a direct confrontational approach in discussions. Attending board meetings could have been stressful.

In the case study, there was workplace harassment when management was pressured to organise programs that suited the directors rather than the clients. This was further aggravated by the chairperson's intimidating ways when he said, "You will do as I say because I am the chairperson".

One of the organisations had a problem with a director who went to the media about a problem in the organisation without the consent of the other directors. Making public comments, including reporting a matter to the media, should be done only with the consent of the whole board.

### **iii) Conflict of interest**

Declaring conflicts of interest must be included in a code of conduct. This was requested, although all of the chairpersons felt that conflicts of interest were not a problem in their organisation.

In the case study, the directors' personal interests took priority over organisational interests, and this resulted in them pressuring management to organise activities that interested them rather than the clients. This, demonstrates a clear conflict of interest (Boyce et al., 2007; Cain, 2008). Directors should make decisions that benefit the organisation and not because the outcome of their decision benefits them.

### **iv) Micro-management**

The board started interfering with management matters by micro-managing employees. By doing so, they were not allowing the CEO to act in her capacity as supervisor to the employees. As mentioned in the proposed 'best practice' guidelines a well-defined and structured governance relationship between the board and executive management was essential. If they had defined roles and responsibilities, they would not have interfered with the CEO's role as a manager (Marx & Davis, 2012b; Moyers, 2012).

### **v) Unethical practices**

The board of the case study organisation carried out unethical practices, such as making governance decisions outside of the board and then writing them into the minutes. As mentioned in the literature review chapter, board members must operate with integrity (Boyce et al., 2007; Moyers, 2012; Weidenfeld, 2004). The board's practice of writing decisions into the minutes, making the minutes not a true account of meetings, was acting in an extremely unethical manner.

As mentioned in the proposed 'best practice' guidelines, a NFP organisation must demonstrate transparency in all its operations. This would include being transparent about its mission, activities and finances (Boyce et al., 2007).

This organisation showed no transparency when emails were circulated to a select few directors and decisions made in that way. Their dealings were not transparent to its membership and even within its own board.

All the issues above are very important for small NFP organisations in Australia. As mentioned in Chapter Two, the ACNC was formed as a national regulator to promote good governance, accountability and transparency for all NFP entities, irrespective of size (*Australian Charities and Not-for-profits Commission Act 2012*). The purpose was to maintain, protect and enhance public trust and confidence in the NFP sector. This Act does not differentiate the expectation placed on NFP organisations based their size.

#### **8.4.2 Purpose of a code of conduct for directors of small NFP organisations**

A code of conduct for directors of small NFP organisations in Australia will contribute towards keeping the ethical standards of the sector in line with the Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia. These standards should be set as the organisations' and directors' common understanding of the professional values and culture the sector should promote and uphold.

Like all codes, the code of conduct for small NFP organisations should not be a stand-alone document. Whilst this code provides broad guidance for standards, integrity and the conduct required from directors of small NFP organisations in Australia, it cannot address all situations. It is not a substitute for personal responsibility, but is intended to serve as a guideline for directors in the way they carry out their daily duties in their capacity as directors.

As mentioned in the literature review chapter, the penalties introduced in the *Association Incorporation Act 2009* do not differentiate directors of small or large NFP organisations. Also, in the reporting requirements small NFP organisations have less stringent requirement but in the penalties, directors

of small NFP organisations are not treated less leniently. For that reason, directors of small NFP organisations need a code of conduct.

### **8.4.3 Proposed Code of Conduct for Directors of Small Not-for-profit Organisations in Australia**

After conducting the four lines of enquiry, the following is the Proposed Code of Conduct for Directors of Small NFP Organisations in Australia.

#### ***Introduction:***

Directors have a duty to act in the best interest of the organisation they serve with honesty, integrity and professionalism.

Directors must uphold and support the principles and objectives of their organisation. They should maintain and strengthen the members' trust and confidence in the integrity of their organisation by their actions and leadership.

Directors are expected to maintain a commitment to ensure that the board meets its contractual obligations and fiduciary responsibilities, and, in doing so, they should adhere to standards of professional conduct that promote and maintain community and government confidence and trust in their organisation.

This Code of Conduct provides guidelines for Directors in carrying out their duties under their Constitution. The Code is not intended to add to, alter or remove from the rights and obligations Directors have by operation of statute or under the general law.

#### **Code of conduct:**

1. Exercise integrity

Directors must not compromise their duties by placing themselves under any financial or other obligation to any individual or organisation that might influence them in the performance of their duties.

2. Be loyal to their organisation

Directors must not act in order to gain financial or other benefits for themselves, their family, friends or business interests. They have a duty to act solely in the interest of their organisation.

3. Be accountable to their members

Directors must consider issues objectively, taking into account the views of others. They are accountable to the organisation's members for their decisions and actions. Directors must record reasons for their decisions, be willing to submit to scrutiny and keep accurate records, restricting information only when the organisation's interests demand.

4. Declare conflicts of interest

Directors must at all times act honestly. They have a duty to declare any private interests relating to their responsibilities. They must take steps such as obey the law, follow policies, adhere to the code of conduct, and disclose actual and potential conflicts of interest that might reasonably be considered to be material to a board decision. They have a duty to act in the best interests of the organisation.

On disclosure by a Director of an actual or potential conflict of interest, the Board is to consider the specific conflict and reach agreement as to how to proceed. If no agreement is reached, the Board is to resolve the matter by a formal vote.

5. Treat others with respect

Directors must be respectful in their dealings with others. They must observe the rights of other people, treat others with courtesy and recognise the different roles and responsibilities that others play in their organisation.

Directors must not use derogatory terms towards others and avoid behaviour that could be construed as disorder. Directors must avoid conduct that:

- is damaging to the pursuit of the organisation's objectives
- is unethical
- is an abuse of power
- causes or involves intimidation, harassment or verbal abuse
- causes or involves discrimination, disadvantage or adverse treatment in relation to employment
- causes or involves prejudice in the provision of service to the members
- harass and discriminate, on the grounds of gender, pregnancy, age, race (including colour, nationality, descent, ethnic or religious background), political affiliation, marital status, disability, homosexuality or transgender
- support others who act in the manner above.

#### 6. Separate governance responsibilities from management role

Directors must not approach staff members other than the CEO for information on work. They are not to give staff members other than the CEO work instructions.

#### 7. Act fairly and equitably

Directors have an obligation to act fairly and equitably. This involves dealing with matters in accordance with the policies of the organisation in a non-discriminatory manner. They must take all relevant facts known to them, or that they should be reasonably aware of, into consideration before making a decision.

#### 8. Do not make public comment without the board's consent

Unless specifically authorised by the board to do so, a director should not communicate with the media or the community on the organisation's operations, or purport to express a view as being the view of their organisation on any matter related to the organisation.

## 9. Maintain confidentiality

Directors should not disclose any confidential information they have acquired in their role as a director in the organisation. They should also ensure that any confidential documents or data in their possession are properly handed to the CEO to be filed in the organisation.

The requirement to be confidential goes beyond the director's time in the organisation. By this it means that directors should be aware that they will continue to be bound by the obligation to protect the confidentiality of the information that has come to their attention in the course of their duties for their organisation even after they leave the organisation.

Consequences for not adhering to the code of conduct:

If this code of conduct is not adhered to, the consequences could be one or more of the following depending on the Board of Directors.

1. Suspension from the Board for a period decided by the board.
2. Expulsion from the board.
3. Cancellation of membership.
4. Legal action may be taken to recover the organisation's damages.
5. Police report if it is a criminal offense.

## **8.5 Answers to the research questions**

### **8.5.1 Research question one**

The first research question is, "What are the significant corporate governance issues that exist in small NFP organisations in Australia?" This question was researched by reviewing the literature. The literature disclosed that there are a number of themes and key ideas that emerged when corporate governance issues were investigated.

The first was an issue that was first raised in Chapter Two when background information on NFP organisations was investigated. This issue was agency theory. It was discovered that small NFP organisations have a very unique

problem that does not exist in large FP companies or NFP organisations and small FP companies, which is the issue of the separation of management and ownership. This issue was evident in the case study.

The literature also showed that NFP organisations, irrespective of their size, face many challenges, six of which were raised by Lyon's (2001). The in-depth interviews proved that some of the challenges in Lyon's (2001) study are legitimate struggles that some boards continue to face.

Lyons (2001) mentioned that NFP organisations struggle to change in response to changes in the economic environment. This was strongly re-informed by the qualitative research when the chairperson of the first organisation said that some of the directors were inexperienced and lacked sufficient business acumen to make business decisions. She went on to say that even if directors had the best of intentions, it was not useful to have them on the board if they were not quick in making business decisions, because they did not understand the matter being discussed. Directors who are unable to engage with business discussions and contribute to the decision-making process will not know how to respond to changes in the economic environment, as mentioned by Lyons (2001).

Another challenge mentioned by Lyons was the struggles between senior staff and the board. The tension between the CEO and the board can be due to the interference of directors in management matters. Such interference can undermine the role of the CEO. According to Lyons (2001), these tensions arise from a lack of clarity about the role of boards and management.

The case study demonstrated a classic example of such a situation when directors started to micro-manage the senior staff and other employees. They wanted to make management decisions by determining activities, purchases and staff management. This is the type of challenge that Lyons (2001) stated was the result of lack of clarity in the role of board and management.

According to the literature, attracting skilled board members is an issue for NFP organisations. The literature indicated that boards in this sector are mainly made up of retired people or people who wish to use the experience as a stepping stone before they move onto FP boards. This was also proven in the in-depth interviews, where eight of the ten chairpersons said that their method of recruiting board members was not successful.

According to Brower and Shrader (2000), directors are able to more easily act in the best interests of all stakeholders because a NFP environment does not have a profit-making motive and the need to be accountable to shareholders. Since directors of NFP organisations are not remunerated for their time on the board, their motive to serve is selfless. Brower and Shrader (2000)'s findings were contrary to the findings of this research. For example, in the case study, the directors had taken the organisation's cheque book to purchase items that were not needed or when the directors pressured the CEO to organise activities that interested them more than the clients. This shows that although the literature states that directors' service is selfless because they volunteer their time to serve on a NFP board, the research proves otherwise.

Another issue raised by the literature as being important to NFP organisations is about 'trust'. Empirical studies indicate that whether people trust or distrust others is attributable to their own personality traits (Sorrentino et al., 1995), while other studies show people's past experiences create a 'trust' or 'distrust' factor in others they interact with (Rotter, 1967). In the case study, clients were beginning to leave the organisation because they lost trust in the leadership. As mentioned in the literature review chapter, this is called 'generalized expectancy' which is a belief as to what can generally be expected of others based on the trustor's history of positive or negative experiences (Rotter, 1967).

The literature also revealed that there has been attempts to provide for good governance of NFP organisations but they have been discrete and disparate

(Dawson & Dunn, 2006). There was hardly any literature specifically on good governance for small NFP organisations, and when it was investigated specifically for Australia, the situation became even dimmer. There was no literature on good governance for small NFP organisations in Australia.

The above were some of the key issues raised through a review of the literature. This then answers the first research question, “What are the significant corporate governance issues that exist in small NFP organisations in Australia?” This leads to the second research question.

### **8.5.2 Research question two**

The second research question is, “Are there appropriate ‘best practices’ that can be included to develop a corporate governance model of best practice specifically for small NFP organisations in Australia?”

This question was answered using the first line of enquiry. As mentioned in other parts of this study, the literature review for this research was divided in two parts. The first review was to determine the key issues and themes while the second part was to investigate current corporate governance ‘best practices’ that are available for small NFP organisations.

The literature revealed that there are no current ‘best practices’ specific for small NFP organisations. Due to the gap in literature, other corporate governance best practices were reviewed to determine their appropriateness for small NFP organisations.

The proposed model that was originally taken from different sectors all over the world was narrowed down to only small NFP organisations and only in Australia. This was done by using the literature-informed proposed corporate governance model of best practice in an online survey of only small NFP organisations in Australia. Once the online survey was completed, the results were analysed to determine the significance so that a model best practice specific to small NFP organisations in Australia could be determined.

The Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia was tested for their validity and reliability. This was done by using the proposed model again in the ten in-depth interviews and the case study. The results showed that the Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia was valid and reliable.

### **8.5.3 Research question three**

The third research question was, “Are small NFP organisations in Australia in a precarious state of survival and extinction?”

This study examined the state of small NFP organisations in Australia by choosing ten small NFP organisations at random from the ACNC register. The subjects were a representative sample. Most of the ten organisations proved to be in a precarious state of survival. 50 percent of the organisations eventually closed down, 10 percent had closed down in the past and reopened, another 30 percent were on the verge of closing down at some point in the past. This result proved that a high percentage of small NFP organisations in Australia are in a precarious state.

### **8.5.4 Research question four**

The fourth and last research question was, “Will a model code of conduct strengthen the governance of small NFP organisations in Australia?” This research did investigate whether a code of conduct will help strengthen small NFP organisations. The chairpersons of the in-depth interviews were asked if they thought a code of conduct would help directors’ behaviour. Nine of the ten Chairpersons interviewed in the in-depth interview indicated that a code of conduct was necessary for a small NFP organisation to provide the directors with a guideline of expected behaviour.

Only one chairperson was sceptical of whether a code of conduct would work; however, she contributed to the discussion by saying that the wordings

for the code were important and that they should not be easily misconstrued or include 'motherhood statements'.

## **8.6 Conclusion**

This chapter is a discussion chapter on the mixed-method research that was conducted for this study. It was important to use both quantitative and qualitative research methods because the quantitative method opened the research to the widest possible audience before narrowing it to the scope of this particular study. The results of the quantitative study were then used to gather greater depth of information through qualitative research.

The qualitative research provides a disturbing scenario, with 50 percent of the organisations closing down and another 40 percent that were on the verge of closing down at some point.

This chapter shows how this mixed-method research brings together all the data obtained in the four lines of enquiry to create the very first Proposed Corporate Governance Model of Best Practice for Small NFP Organisations in Australia and a Code of Conduct for Directors of Small NFP Organisations in Australia. Unlike many codes of conduct that are available worldwide, this code of conduct provides for consequences if directors do not adhere to the code.

## **Chapter 9: Conclusion**

### **9.1 Introduction**

Chapter Nine concludes this study by discussing the implications of this research, the limitations of the methodology and avenues for future research. As mentioned in the introduction to this research, this study stems from a few pressing issues in the industry that have impacted on the NFP sector. Some of these issues are the closing down of good services due to a lack of funds, the constant survival mode small NFP organisations are in and the difficulty in attracting skilled directors. It is also common knowledge amongst small NFP practitioners that they are in a precarious state because of limited funds.

Therefore, the focal point of this research was financial management of small NFP organisations. When investigating financial management, it was discovered that this topic was linked to corporate governance. Since financial management is not a 'stand-alone' problem, as it is part of corporate governance, issues surrounding corporate governance had to be investigated. This led to the development of the research topic, which is *The role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organisations in Australia*.

The following section presents the implications of the research, such as its contributions to research, theory and practice.

### **9.2 Implications of the research**

#### **9.2.1 Contributions to research**

There is a considerable field of knowledge and a broad body of literature about corporate governance, financial management, NFP organisations, best practices and codes of conducts. Despite an abundance of knowledge and

literature in the above topics, there is limited research available for small NFP organisations in any of the topics above.

The purpose of this research was to propose a corporate governance model of best practice and a code of conduct for directors of small NFP organisations in Australia. A review of the literature revealed a lack of strong context-specific theories and methodologically rigorous studies in the field. When literature in the field was completely non-existent, it was difficult to move forward. The lack of literature for small NFP organisations in any of the fields above was a major limitation to this research. This limitation was overcome by investigating other studies on corporate governance and financial management that had been carried out for other sectors, such as companies and NFP organisations. These studies were discussed for their suitability for small NFP organisations in Australia so that a theoretical framework could be developed.

From that framework, a way forward to include small NFP organisations in Australia was created. This was developed by involving practitioners through an online survey. The data that were collected was analysed through SPSS17, producing a reduced set of data that showed significance of the statements included as part of the present study. These data were then tested qualitatively through a smaller sample of practitioners to separate actual corporate governance issues from those that were not meaningful. The condensed data were tested through a more rigorous qualitative case study to produce the final version of a Corporate Governance Model of Best Practice and a Code of Conduct for Directors of Small NFP Organisations in Australia.

This study, through a rigorous mixed-method of data collection and analysis, leads the way by contributing to effective corporate governance mechanisms specifically developed for small NFP organisations anywhere else, as far as that can be determined within the scope of this research. This research makes a significant contribution to research by way of testing and developing a corporate governance best practice model specific to the small NFP

organisation context through quantitative and qualitative data analysis techniques that are rare in the disciplinary area.

### **9.2.2 Contributions to theory**

Insights gained from this research can be used to develop policies and make changes to legislation that will strengthen small NFP organisations in Australia. The in-depth interviews conducted as part of this study demonstrated that 50 percent of the organisations were closing down in the few months after the interviews and a further 40 percent had been on the brink of closing down on one or two occasions in the past.

For the reasons above, a risk management policy was crucial for the ongoing sustainability of small NFP organisations in Australia. The risk management policy must include potential risk, the impact of the risk and strategies to avoid or overcome such risks. Boards of Directors should discuss different types of risks potentially faced by their organisation such as financial, marketing and reputation, environmental and external, operational and management.

Another practical and useful policy is an induction policy for directors, staff and volunteers. This induction policy must acknowledge that the different people that are involved in the organisation have different roles and responsibilities. A different induction program can be developed for each group but the policy would be the same.

Other practical policies identified to be most relevant for small NFP organisations from this study as discussed in the literature review are:

1. whistleblower policy
2. conflict of interest policy
3. investment policy
4. staffing policy with an equal opportunity section
5. programming policy

The following are three specific legislative changes that can be introduced in the *Australian Charities and Not-for-profit Commission Act 2012*. The first are penalties for charities and NFPs and their Directors for certain offences similar to the changes made in the *Associations Incorporation Act 2009* as mentioned in section 2.3.4 (Council of Social Service of New South Wales, 2013). In the 2009 Act, NSW Fair Trading is allowed to issue penalty notices for certain offences (Council of Social Service of New South Wales, 2013). If a similar change is made to the *Australian Charities and Not-for-profit Commission Act 2012*, it will provide ACNC more power to regulate charities and NFP organisations.

The second change that can be made to the *Australian Charities and Not-for-profit Commission Act 2012* is to impose a penalty on Directors of up to \$6600 if they neglect to disclose any conflict of interest between their own affairs and the affairs of the charity or NFP organisation similar to the penalty introduced in the *Associations Incorporation Act 2009* (Council of Social Service of New South Wales, 2013).

The third change that can be made to the *Australian Charities and Not-for-profit Commission Act 2012* is to impose a penalty of up to \$26 400, or a two year imprisonment on Directors of charities and NFP organisations who use their position or information for a dishonest purpose (Council of Social Service of New South Wales, 2013).

As extant literature is scant within the context of small NFP organisations, this study contributes significantly to the theory by providing a theoretical framework that specifically suits the small NFP context. This study also developed a code of conduct and corporate governance best practice model that are readily applicable to the small NFP sector within Australia and elsewhere by addressing the context specific attributes.

By introducing strong policies, making changes to legislation and enforcing the use of a code of conduct for directors and corporate governance best practice model, the small NFP sector in Australia will be strengthened. These

changes will make a positive contribution to the Australian economy because they can, in time, grow into large organisations that employ people and contribute to the GDP in a larger scale.

### **9.2.3 Contributions to practice**

In Australia, the requirements for small companies and NFPs are less stringent than their larger counterparts. This does not pose a problem for small companies because they are private companies where the owner is also the manager. As there is no separation between ownership and control, it can be inferred that the owner will act in the best interests of the company, because he or she will reap the benefits of the company's success.

In the case of small NFP organisations, there is a clear separation of ownership and control. The one controlling the organisation does not own it and may make decisions that benefit herself or himself, even if those decisions are not in the organisation's best interests. Furthermore, as can be seen from Chapter Two with regard to reporting requirements, these small NFPs are not closely regulated or monitored by their administering bodies, such as NSW Fair Trading or ASIC.

This study raises the need to address the problem of lack of monitoring and accountability amongst small NFP organisations in Australia. This is especially necessary because of the agency problem, which is the separation of ownership and management.

For the first time, only small NFP organisations with a turnover of under \$250 000 were researched, their corporate governance problems investigated and practitioners interviewed so that only small NFP organisations' corporate governance issues could be identified. By undertaking these activities, this study identified governance mechanisms that could be used to financially secure small NFP organisations in Australia. These mechanisms are a corporate governance model of best practice and a code of conduct for directors. This study will make a significant contribution to practice by

reducing the number of NFPs that become insolvent due to the lack of good corporate governance, which will strengthen this sector.

These mechanisms can be implemented in two ways. Firstly, they could be self-regulating without being monitored by its administering bodies, such as NSW Fair Trading or ASIC. Self-regulating mechanisms have been successfully implemented in Austria, Switzerland, United Kingdom, Poland, Germany and the Netherlands and may also work in Australia. These mechanisms can be disseminated through the state regulatory bodies such as NSW Fair Trading or the ACNC and ASIC.

Secondly, as mentioned in Chapter Two, the literature demonstrates that NFP organisations are being made more accountable in Australia through legislation (Bies, 2010; Productivity Commission, 2010). This is an attempt to promote good governance, accountability and transparency in the sector. This study revealed that all ten of the organisations that participated in the in-depth interview had a conflict of interest policy and/or register. This could have been a result of penalties introduced through legislation for directors who did not declare a conflict of interest. Legislating corporate governance mechanisms compel small NFP organisations to act more accountably, hence improving the sector's sustainability.

The implication of not doing anything to strengthen small NFP organisations in Australia may be dire. This research reveals that without more financial discernment on the part of boards and a well-structured partnership between boards and executives, more small NFP organisations could close down.

Moving from the contributions of the study to research, theory and practice is the section on the limitations of the methodology, which will be discussed below.

## **9.3 Limitations to the methodology**

### **9.3.1 Online survey**

Like any type of survey, the online survey has its advantages and disadvantages. While the advantages of an online survey are manifold, as mentioned in Chapter Six, this type of data collection also poses a few disadvantages.

The first disadvantage is that online surveys are carried out remotely, without the presence of the researcher. Participants are not prompted to take part in the survey, resulting in a low response rate. Also participants cannot clarify questions if the researcher is not present, while the researcher does not have the opportunity to probe further (Cooper & Schindler, 2003).

Although this research produced 32 percent response rate, which is above the 20 percent response rate that is considered satisfactory, the literature indicates that over time, online survey response rates have declined (Sheehan, 2001).

As mentioned in the background chapter, CEOs of small NFP organisations are expected to multitask at work. Time is limited and it can be very enticing to press the 'delete' button when an email inviting them to participate in yet another survey arrives in their inbox. A drawback identified by Arunachalam (2012) was the 'invisibility' of the invitation email in the volume of electronic correspondence that the participants could have received when the invitation was sent out. The invitation could have been overlooked due to competing priorities and an overload of work (Arunachalam, 2012).

The literature indicates that participants who receive a large volume of unsolicited emails are also more likely to be sceptical of such emails (Porter & Whitcomb, 2003). The literature also indicates that CEOs who are unfamiliar with computers or who have restricted access to the internet would have had limited opportunities to participate in the online survey (Leedy & Ormrod, 2010).

Lastly, when the survey is completed remotely, the researcher has no control over whether the questionnaire is completed by the CEOs or their delegated representatives (Easterby-Smith, et al., 2008). To address these limitations, four lines of enquiry were used, employing a mix of literature review, quantitative and qualitative methods to enhance validity and credibility, and to ascertain if the results reinforce each other (Cooper & Schindler, 2003).

### **9.3.2 In-depth Interview and case study**

Besides the advantages and disadvantages, there are also other limitations in the way the interviews are carried out. Firstly, the researcher must use appropriate body language and keep their personal opinions from the interview. The interview will be more successful if the interviewee is made to feel comfortable and the researcher appears interested in what he or she is saying (Boyce & Neale, 2006).

Secondly, these types of data collection methods are prone to bias because the researcher may lead the interviewee in a particular direction to be able to 'prove' their research assumptions. This may result in biased responses. Participants may also be biased due to their stake in the research topic or for other reasons (Boyce & Neale, 2006).

Thirdly, in-depth interviews and case studies can also be time consuming. Each interview has to be carried out, analysed and reviewed to see if they are presented well. The researcher may also need to listen to the recordings a few times to ensure that he or she is recalling information accurately (Boyce & Neale, 2006).

In this particular research, when the question on 'business plan' was asked, the interviewees knew if they had a Business Plan or not but did not know the contents of the Business Plan such as if it had marketing, operational or staffing plans. This could be because the interviewees were Chairpersons and were not involved in the day-to-day running of the place.

Like all research methodology, this study also had its limitations, but compared to the advantages that were discussed in previous chapters, the limitations were not detrimental to the outcome of the research.

#### **9.4 Avenues for future research**

Although this research is an academic study, it has many practical merits to contribute to the industry. Just like this research, there are many avenues for future research that can also have a practical value. This research is one of the few on small NFP organisations and the first in corporate governance of small NFP organisations in Australia, or anywhere else, as far as can be determined within the scope of this research. For that reason, the potential for future research for this section of the sector is vast.

Boards of small NFP organisations are expected to behave as prudent stewards of limited resources, yet they need to be more entrepreneurial and take new kinds of risks. One way forward is to build partnerships with other small NFPs for the purpose of collaboration on projects.

The way forward is to draw from the corporate governance model of best practice and use that model to strengthen internal governance. Projects have a greater chance of success if they have robust internal governance. An example of a future research, then, would be to develop how to build effective partnerships to strengthen collaboration and improve engagement, especially in the delivery of government-funded services. Future research will be able to synthesise and build on the outcomes of this research.

The Code of Conduct for Directors of Small NFP Organisations in Australia that has been developed is useful for internal use; however, it does not guarantee that appropriate directors can be recruited. A follow-up research could be on director recruitment and induction. Recruiting suitable qualified and experienced directors for small NFP organisations is a suitable future

study. Rigorous and new knowledge about governance and boards will further strengthen this sector.

## **9.5 Conclusion**

Since small NFP organisations providing good services were closing down due to a lack of funds, the need to investigate the issues surrounding the precarious state these types of organisations were in became apparent. A greater need to carry out this research presented itself when a review of the literature disclosed a lack of strong context-specific theories and methodologically rigorous studies in financial management, corporate governance, best practice models and codes of conduct for directors of small NFP organisations.

In an effort to answer the stated research questions, quantitative and qualitative data were collected using four lines of enquiry, which are literature review, an online survey, ten in-depth interviews and a case study. A mixed-method research methodology was employed because the quantitative method opened the research to the widest possible audience before narrowing it to the scope of this particular study.

Validity and reliability were ensured by testing and re-testing results until they were dealing only with issues related to small NFP organisations in Australia. At the end of a long and rigorous process, this research concludes that small NFP organisations in Australia are in dire need of help and guidance.

This study revealed:

- problematic practices, which are comparable to criminal behavior, such as intimidation, harassment, mismanagement of funds and other corrupt practices, such as putting pressure on directors to change their vote and manipulation of corporate records.
- 100 percent of the organisations interviewed had directors that did not know how to interpret financial reports.

- 90 percent of the organisations interviewed were closing down or had been on the verge of closing down at one or more times in the life of the organisation.
- 80 percent of the organisations did not have successful director recruitment process. Some of the comments made regarding the quality of directors were:
  - v) “We had ‘rogues’ on the board.”
  - vi) “We ‘hope for the best’ when directors are elected.”
  - vii) “We went to ‘hell and back’ because of the previous board.”
  - viii) “Our board was dysfunctional. There was in-fighting and aggressive behavior at board meetings.”
- 40 percent of the organisations that were closing down could have continued their operation if they had partnered with other organisations that could complement their services.
- Transparency, declaration of conflicts of interest, confidentiality, integrity are some of the codes that the interviewees felt must be included in a code of conduct that was to be specially developed for small NFP organisations in Australia.
- There is a need for a code of conduct for directors that clearly stipulates consequences if directors breach the code of conduct.

This scenario presents a weak and volatile sector that is in a precarious state. It needs much attention and focus. This study concludes that there is an overwhelming need for mechanisms that will strengthen and provide stability to the small NFP sector in Australia. The corporate governance mechanisms that have been specifically developed for this sector through this research are:

- A Corporate Governance Model of Best Practice for Small NFP Organisations in Australia.
- A Code of Conduct for Directors of Small NFP Organisations in Australia.

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## Appendices

### Appendix A: Questionnaire

#### Organisational information:

1. Which of the following groups best describes your organisations activities?
  - Culture and recreation (sports, art, museums, recreational, social clubs).
  - Education and research (schools, universities, TAFE, policy studies).
  - Health (hospitals, rehabilitation, nursing homes, public health, health education).
  - Social Services (child welfare, youth services, family services, elderly and disabled people, emergency relief, income support).
  - Environment (conservation of natural resources, pollution control, animal protection, wildlife and countryside preservation).
  - Housing ( Aboriginal Land Council, community housing)
  - Employment (employment and training such as Jobs Australia, Joblink Plus).
  - Law, Advocacy and Politics (advocacy organisations, minority groups, civic associations, legal services, crime prevention, rehabilitation of offenders, victim support, political parties).
  - Philanthropic Intermediaries and Volunteerism Promotion (grant making trusts, fundraising organisations, intermediary organisations).
  - International Activities (exchange programmes, development assistance, disaster relief, human rights and peace organisations).
  - Religion
  - Business, professional associations and unions. (employers organisations, trade unions, professional associations.)
  - Other – please write in

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(Productivity Commission, 2010; Salamon & Anheier, 1997).

2. What type of business structure best describes your organisation?
  - Incorporated Association
  - Company limited by guarantee.
  - Co-operative
  - Body co-operative

- Other – please state \_\_\_\_\_  
(Lyons, 2001; Twaits, 1998)

**CEO information:**

3. What is your age?
  - a) 20-35
  - b) 36-50
  - c) Over 50
  
4. What is your gender?
  - a) Male
  - b) Female
  - c) Prefer not to say
  
5. What is your educational level?
  - a) High school
  - b) TAFE or equivalent
  - c) Undergraduate
  - d) Postgraduate
  - e) Other

(Shamima, 2005)

There are 50 statements listed below. The first 30 questions are on Corporate Governance and the rest of the questions are on Financial Governance. Respondent will have a choice of six options to choose from. They are:

- a) Strongly agree
- b) Agree
- c) Somewhat agree
- d) Somewhat disagree
- e) Disagree
- f) Strongly disagree

**Corporate governance questions:**

6. The Board of Directors' roles and responsibilities are clearly defined in a written document in the organisation.
7. The board and CEO have a well-structured governance relationship in a written format.

8. The Board sets annual Key Performance Indicators (KPI) for the CEO based on its mission and vision and carries out an annual job appraisal.
9. The Board and CEO set annual KPIs for the organisation based on its mission and vision.
10. The Board evaluates the organisation's performance using its KPIs at least once a year.
11. Board vacancies are formally advertised and directors formally recruited.
12. New directors have to undergo an orientation process where they are inducted about the organisation and its activities.
13. The organisation has a clearly articulated mission and vision.
14. The organisation's activities, beneficiaries and long-term objectives are written down.
15. The organisation has a clearly articulated Business Plan.
16. Each year the CEO prepares the following year's program plan which is reviewed and adopted by the Board.
17. The Board has between three and seven members.
18. The organisation has a Code of Ethics or Code of Conduct for the CEO and Board.
19. The organisation has a written policy on whistleblower protection.
20. The directors are provided with all documents and details pertaining to an issue before they make a decision.
21. The organisation has a clearly articulated and transparent conflict of interest policy.
22. The Board evaluates the conflict of interest policy from time to time and ensures compliance.
23. Agreements and contracts are read through before they are signed according to the conflict of interest policy.
24. Only directors on the board sign agreements and contracts on behalf of the organisation.
25. The organisation's mission, vision, activities, beneficiaries and long-term objectives are transparent, readily available, for example online.
26. The organisation has a document retention policy.

27. The organisation always meets all its reporting deadlines.
28. The directors are not related to each other (e.g by birth, marriage or are in a de facto relationship).
29. The Directors are not related to the CEO in the manner explained in no 35 above.
30. The directors are independent of each other and are not childhood friends, or friendly on another social level (eg belong to the same country club or friendship group, etc).
31. The directors and CEO are independent of each other and are not childhood friends, or friendly on another social level (eg belong to the same country club or friendship group, etc).
32. Directors discuss issues in a constructive and collegial manner at board meetings even if robust discussions take place.
33. Directors are provided with all relevant business papers at least a week before a board meeting.
34. The organisation only carries out clearly defined core business in accordance with the mission, vision and business plan.
35. Over the past 5 years, the organisation has built up cash levels.

**Financial control questions:**

36. Signatories check invoices before cheques are signed off according to the conflict of interest policy.
37. Financial documents are made available to board members for review at any time and are provided in a timely manner prior to board meetings.
38. The organisation only engages in fundraising activities with the appropriate fundraising permits (authority to fundraise).
39. An annual audit is carried out or an independent Certified Public Accountant (CPA) thoroughly reviews the organisation's financials on an annual basis.
40. A new audit firm or a new CPA is appointed every 5 years.
41. The CEO ensures that a few quotes are first obtained from service providers. The quotes are then compared and the most suitable quote chosen before the service provider is engaged for service.

42. Quotes that are too expensive and are out of the regular payment for a similar service are refused.
43. Financial documents are securely kept for at least seven years.
44. The CEO and other key employees' remuneration are reviewed annually by the Board.
45. The organisation has a clearly articulated investment policy.
46. The directors have the knowledge, skills and ability to interpret financial reports.
47. The organisation always meets its acquittal deadlines.
48. The organisation has not been on the verge of closing down in the last 5 years.
49. The CEO has formal financial training.
50. The organisation has an annual budget. This is used to check variances of budget figures to actual expenses.
51. The organisation has a 3-year budget.
52. The organisation has a cash flow statement which is used to determine the financial standing of the organisation at any period.
53. Directors of the board do not receive any payments for services rendered to the organisation.
54. The Board receives the audit/financial report and meets with the auditor or independent CPA at least once before the AGM.
55. The Board identifies for the auditor a different area of operation each year for a more in-depth audit analysis.

## Appendix B: Invitation letter to participate in the online survey



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University of New England  
Armidale NSW 2351  
Australia  
Phone 02 6773 3276  
Fax 02 6773 3148  
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23<sup>rd</sup> May, 2014

Dear Chief Executive Officer,

**Re: The role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organizations in Australia.**

I wish to invite you to participate in my research project to share the corporate governance and financial control measures used in your organisation. You will only be required to spend about 25 minutes completing a questionnaire.

This research is part of my PhD in the UNE School of Business at the University of New England. My supervisors are A/Prof Martin Hovey and A/Prof Bernice Kotey.

Please go to <https://www.surveymonkey.com/s/TNRY5ZL> to complete the survey. Could you please complete this survey by Friday, 28<sup>th</sup> June, 2014.

The aim of my research is to explore the role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organizations in Australia.  
Thank you.

Yours sincerely,  
Daisy William

## Appendix C: Information sheet for participants



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Armidale NSW 2351  
Australia  
Phone [02 6773 3276](tel:0267733276)  
Fax [02 6773 3148](tel:0267733148)  
[www.une.edu.au/](http://www.une.edu.au/)



I wish to invite you to participate in my research project, described below.

My name is Daisy William and I am conducting this research as part of my PhD in the School of Business, Economics and Public Policy at the University of New England. My supervisors are A/Prof Martin Hovey and A/Prof Bernice Kotey.

<b>Research Project</b>	<b>The title of the project</b>
<b>Aim of the research</b>	The research aims to explore the role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organizations in Australia.
<b>Online survey</b>	I would like to conduct an online survey. You will be asked to complete one questionnaire via survey monkey. This questionnaire will consist of 50 questions that will take approximately 25 minutes to answer.
<b>Confidentiality</b>	No individual or organisation will be identified by name in any publication of the results because this is an anonymous research and names will not be collected.
<b>Participation is Voluntary</b>	Please understand that your involvement in this study is voluntary and I respect your right to withdraw from the study at any time. You may discontinue the survey at any time without consequence and you do not need to provide any explanation if you decide not to participate or withdraw at any time.
<b>Questions</b>	The questions will not be of a sensitive nature: rather they are general, aiming to enable you to enhance my knowledge of the challenges and opportunities for better NFP governance.

<b>Use of information</b>	I will use information from the survey as part of my doctoral thesis, which I expect to complete in June 2015. Information from the survey may also be used in journal articles and conference presentations before and after this date.
<b>Upsetting issues</b>	It is unlikely that this research will raise any personal or upsetting issues but if it does you may wish to contact your local Lifeline at 131114.
<b>Storage of information</b>	All electronic data will be kept on a password protected computer in the Principal researcher's office at the University of New England. Only the research team will have access to the data.
<b>Disposal of information</b>	All the data collected in this research will be kept for a minimum of five years after successful submission of my thesis, after which it will be disposed of by deleting relevant computer files, and destroying or shredding hardcopy materials.
<b>Approval</b>	This project has been approved by the Human Research Ethics Committee of the University of New England (Approval NoHE14-044, Valid to 01/05/2015).
<b>Contact details</b>	<p>Feel free to contact me with any questions about this research by email at <a href="mailto:dwilli46@une.edu.au">dwilli46@une.edu.au</a> or by phone (02) 6771 3606.</p> <p>You may also contact my supervisors. My Principal supervisor's name is A/Prof Martin Hovey and he can be contacted at <a href="mailto:m.hovey@une.edu.au">m.hovey@une.edu.au</a> or 02 6773 3276 and my Co-supervisor's name is A/Prof Bernice Kotey and she can be at <a href="mailto:b.kotey@une.edu.au">b.kotey@une.edu.au</a> or 02 6773 2830.</p>
<b>Complaints</b>	Should you have any complaints concerning the manner in which this research is conducted, please contact the Research

Ethics Officer at:  
Research Services  
University of New England  
Armidale, NSW 2351  
Tel: (02) 6773 3449 Fax: (02) 6773 3543  
Email: [ethics@une.edu.au](mailto:ethics@une.edu.au)

Thank you for considering this request and I  
look forward to further contact with you.

regards,

Daisy William

## Appendix D: In-depth interview questions

1. Over the last 5 years, has your organisation built-up cash levels that are set aside as a reserve?
  - Have you ever operated on a deficit?
  - Have you ever closed your organisation due to insufficient funds?
2. How are board members recruited in your organisation?
  - How do the vacancies happen?
  - Have the vacancies ever been advertised?
  - Is your current recruitment method successful or do you have problems with it?
3. Does your organisation have a clearly articulated Business Plan?
  - How often is it updated?
  - What is the content of your Business Plan (do you have marketing, staffing and operational plans)
4. When an issue arises, how are the directors provided information regarding the matter before a decision is reached?
  - Email, documents, telephone conversation?
5. Does your organisation have a Conflict of Interest Policy
  - Does your board evaluate the Conflict of Interest Policy from time to time to ensure compliance?
  - Do you experience any conflicts at meetings?
  - Have the conflicts ever unresolved?
6. Are agreements and contracts read through before they are signed?
  - Are the agreements weighted against the organisation's Conflict of Interest Policy?
  - Have you had any problems with contracts?
7. Who signs agreements and contracts on behalf of the organisation?
  - What agreements are signed by other personnel such as the CEO, staff or volunteers?
8. When are board members provided with business papers to be discussed at a board meeting?
9. Does your organisation carry out activities that are not deemed 'core business'?
10. Does your organisation have a budget?
  - Is your budget used to check variances of budget figures to actual expenses?
11. Does your organisation have a cash flow statement?
  - Is it used in your daily operation to determine the financial standing of your organisation at any period?
12. Does your organisation have funds to employ a full-time CEO?
13. What is the educational level of your CEO?

14. Does your CEO have financial training?
- What type of financial training does he or she have?
  - Do you think he/she needs more guidance in financial matters?
  - What type of financial problems does the CEO face?
15. How would a Code of Conduct for directors help your organisation?
16. What aspects do you consider important in respect to a Code of Conduct ?
17. What type of governance or financial management support does your organisation need from the government?

## Appendix E: Invitation letter to participate in an in-depth interview



UNE Business School  
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Australia  
Phone 02 6773 3276  
Fax

---

10<sup>th</sup> November 2014

Dear Chairperson,

**Re: The role of corporate financial control and governance mechanisms in the successful financial management of a small not-for-profit organisation in Australia.**

I wish to invite you to participate in my research project to share the corporate governance and financial control measures used in your organisation. You will only be required to spend about 45 minutes in an interview.

This research is part of my PhD in the UNE School of Business at the University of New England. My supervisors are A/Prof Martin Hovey, A/Prof Bernice Kotey and Dr Sujana Adapa.

The aim of my research is to explore the role of corporate financial control and governance mechanisms in the successful financial management of small not-for-profit organizations in Australia.

This project has been approved by the Human Research Ethics Committee of the University of New England (Approval No....., Valid to .././.....).  
Thank you.

Yours sincerely,  
Daisy William

**Appendix F: Consent form**

**CONSENT FORM  
for PARTICIPANTS**

**Research Project:** The role of corporate financial control and governance mechanisms in the successful financial management of a small not-for-profit organization in Australia

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I, .....,  
have read the information contained in the Information Sheet for Participants and any questions I have asked have been answered to my satisfaction. Yes/No

I agree to participate in this activity, realising that I may withdraw at any time. Yes/No

I agree to the interview being audio recorded Yes/No

I am older than 18 years of age.  
Yes/No

.....  
Participant                      Date

.....  
Researcher                      Date

## Appendix G: Guidelines & Protocol for conducting telephone interviews



### Human Research Ethics Committee Ethics Approval for Research Involving Humans Guidelines & Protocol for Conducting Telephone Interviews

## Telephone Interviews

Because telephone interviews are an intrusive research tool, the researcher will need to demonstrate the following to the Committee's satisfaction:

- ▶ Why it is the preferred method of surveying and why you could not obtain the information by a less intrusive means, e.g. self-administered questionnaires.
- ▶ If questions are of a sensitive nature, how the researchers intended to minimise the potential for psychological harm and what referral protocol exists for people who experience emotional distress resulting from the interview or the request to be interviewed.

As a general rule, the minimum requirement is that the potential participants receive a written Information Sheet for Participants that forewarns them that telephone contact will be made. In addition to the normal requirements for an information sheet it should also address the following:

- ▶ How names, addresses and telephone numbers of the target population were obtained.
- ▶ The desired interviewee and why this person was chosen.
- ▶ The reasons for obtaining information via a telephone interview.
- ▶ An example of the nature of the questions they will be asked.
- ▶ When the interview will take place and the time required.
- ▶ How the potential participants may prevent telephone contact, e.g. the use of a refusal form that can be returned to the researcher.

A telephone interview script must be submitted with the application.

- ▶ The introduction should be short and to the point, clearly identifying the caller, for whom the research is being undertaken and referring to the letter. It should also be stated who is funding the research (where relevant) and from whom ethics approval has been obtained. In asking to speak to the intended interviewee, the specific nature of the call should not be disclosed to a third party. For example, it is sufficient to say "I would like to speak to ... regarding a letter we sent to him/her about mental health", rather than "I would like to speak to ... regarding a letter we sent to him/her about how often he/she see his/her therapist".

- ▶ It must cater for people who do not receive the information letter, e.g. people who have changed address and retained their telephone numbers or lost mail. If it is necessary to interview such people.
- ▶ The interview cannot proceed until such time as they are provided with an Information Sheet for Participants if they are willing to receive one.

## **State And Federal Laws Concerning The Taping Of Telephone Conversations**

Telecommunications Act 1997 (CTH)

<http://www.privacy.gov.au/act/telecom/index.html>

Listening Devices Act 1984 (NSW)

[http://www.lawlink.nsw.gov.au/lawlink/privacynsw/ll\\_pnsw.nsf/pages/PNSW\\_03\\_listendevic](http://www.lawlink.nsw.gov.au/lawlink/privacynsw/ll_pnsw.nsf/pages/PNSW_03_listendevic)

National Industry Standard for Telemarketing and Research Calls

[http://internet.aca.gov.au/WEB/STANDARD//pc=PC\\_100991](http://internet.aca.gov.au/WEB/STANDARD//pc=PC_100991)

prohibit the recording of phone conversations except where all parties to the conversation provide consent.

This legislation requires that you obtain consent from all participants before you publish any research based on telephone conversations with these participants. As these laws protect privacy, courts will apply them strictly. This means that the consent obtained from participants should be specific, and identify how the information will be stored, used and distributed. The level of detail in the consent form will depend on the amount of personally identifying information that is collected, stored and accessed on an ongoing basis.

### **Examples:**

- ▶ if the information which is being collected has no identifying details, so that the parties to the conversation can never be traced or identified by people accessing the primary data, the privacy concerns will be much less, and the consent can be more general;
- ▶ if identifying information is collected, and then removed from the information, that is distributed, privacy concerns will be increased. Forethought must be given to how the primary data with its identifying details will be securely stored and limiting access to that data and to any system which could allow the primary data and the aggregate data to be matched. The consent will need to allow retention of the identifying data and future access to it.

Consent forms should, therefore, contain the following information:

- ▶ where the information will be published;
- ▶ who will have access whilst the information is stored at UNE;
- ▶ what will happen to the material once the 5 year storage period has expired;
- ▶ that the researchers are subject to strict confidentiality obligations when collecting data.

Whether or not identifying data is to be recorded, the researchers involved in collecting the data will inevitably hear information that may be regarded as private or confidential. If there is not already a confidentiality agreement in place covering the work of the researchers, then they should also sign a confidentiality undertaking.

By taking the above steps the researchers ensures that the participants understand the exact nature of the project and have given their fully informed consent for the use of the information recorded.

## Appendix H: The results for the 30 corporate governance questions

	Strongly agree	Agree	Somewhat agree	Somewhat disagree	Disagree	Strongly disagree
<b>CG1: The Board of Directors' roles and responsibilities are clearly defined in a written document in the organisation.</b>	50.0 0% 53	14.15 % 15	16.9 8% 18	13.2 1% 14	2.83% 3	2.83 % 3
<b>CG2: The board and CEO have a well-structured governance relationship in a written format.</b>	39.6 2% 42	22.64 % 24	21.7 0% 23	8.49 % 9	4.72% 5	2.83 % 3
<b>CG3: The Board sets annual Key Performance Indicators (KPI) for the CEO based on its mission and vision and carries out an annual job appraisal.</b>	42.4 5% 45	10.38 % 11	27.3 6% 29	12.2 6% 13	5.66% 6	1.89 % 2
<b>CG4: The Board and CEO set annual KPIs for the organisation based on its mission and vision.</b>	42.4 5% 45	10.38 % 11	29.2 5% 31	10.3 8% 11	6.60% 7	0.94 % 1
<b>CG5: The Board evaluates the organisation's performance using its KPIs at least once a year.</b>	40.5 7% 43	11.32 % 12	26.4 2% 28	13.2 1% 14	6.60% 7	1.89 % 2
<b>CG6: Board vacancies are formally advertised and directors formally recruited.</b>	33.0 2% 35	8.49% 9	20.7 5% 22	16.9 8% 18	9.43% 10	11.3 2% 12
<b>CG7: New directors have to undergo an orientation process where they are inducted about the organisation and its activities.</b>	36.7 9% 39	10.38 % 11	15.0 9% 16	18.8 7% 20	10.38 % 11	8.49 % 9
<b>CG8: The organisation has a clearly articulated mission and vision.</b>	75.4 7% 80	10.38 % 11	12.2 6% 13	0.00 % 0	0.00% 0	1.89 % 2
<b>CG9: The organisation's activities, beneficiaries and long-term objectives are written down.</b>	57.5 5% 61	10.38 % 11	26.4 2% 28	4.72 % 5	0.00% 0	0.94 % 1
<b>CG10: The organisation has a clearly articulated Business Plan.</b>	59.4 3% 63	14.15 % 15	13.2 1% 14	7.55 % 8	3.77% 4	1.89 % 2
<b>CG11: Each year the CEO prepares the following year's program plan which is reviewed and adopted by the Board.</b>	50.0 0% 53	11.32 % 12	26.4 2% 28	6.60 % 7	4.72% 5	0.94 % 1

	48.1	5.66%	19.8	5.66	6.60%	14.1
<b>CG12: The Board has between three and seven members.</b>	1%	6	1%	%	7	5%
	51		21	6		15
<b>CG13: The organisation has a Code of Ethics or Code of Conduct for the CEO and Board.</b>	34.9	13.21	26.4	7.55	7.55%	10.3
	1%	%	2%	%	8	8%
	37	14	28	8		11
<b>CG14: The organisation has a written policy on whistleblower protection.</b>	5.66	4.72%	2.83	7.55	13.21	66.0
	%	5	%	%	%	4%
	6		3	8	14	70
<b>CG15: The directors are provided with all documents and details pertaining to an issue before they make a decision.</b>	45.2	16.98	28.3	3.77	3.77%	1.89
	8%	%	0%	%	4	%
	48	18	30	4		2
<b>CG16: The organisation has a clearly articulated and transparent conflict of interest policy.</b>	40.5	12.26	27.3	6.60	7.55%	5.66
	7%	%	6%	%	8	%
	43	13	29	7		6
<b>CG17: The Board evaluates the conflict of interest policy from time to time and ensures compliance.</b>	33.0	10.38	26.4	9.43	10.38	10.3
	2%	%	2%	%	%	8%
	35	11	28	10	11	11
<b>CG18: Agreements and contracts are read through before they are signed according to the conflict of interest policy.</b>	40.5	10.38	28.3	6.60	8.49%	5.66
	7%	%	0%	%	9	%
	43	11	30	7		6
<b>CG19: Only directors on the board sign agreements and contracts on behalf of the organisation.</b>	59.4	15.09	18.8	3.77	1.89%	0.94
	3%	%	7%	%	2	%
	63	16	20	4		1
<b>CG20: The organisation's mission, vision, activities, beneficiaries and long-term objectives are transparent, readily available, for example online.</b>	59.4	12.26	18.8	5.66	3.77%	0.00
	3%	%	7%	%	4	%
	63	13	20	6		0
<b>CG21: The organisation has a document retention policy.</b>	11.3	7.55%	7.55	4.72	13.21	55.6
	2%	8	%	%	%	6%
	12		8	5	14	59
<b>CG22: The organisation always meets all its reporting deadlines.</b>	59.4	13.21	21.7	2.83	1.89%	0.94
	3%	%	0%	%	2	%
	63	14	23	3		1
<b>CG23: The directors are not related to each other (e.g by birth, marriage or are in a de facto relationship).</b>	40.5	16.04	25.4	9.43	3.77%	4.72
	7%	%	7%	%	4	%
	43	17	27	10		5
<b>CG24: The Directors are not related to the CEO in the manner explained above.</b>	42.4	16.04	24.5	8.49	4.72%	3.77
	5%	%	3%	%	5	%
	45	17	26	9		4
<b>CG25: The directors are independent of each other and are not childhood friends, or friendly on another social</b>	37.7	16.04	23.5	10.3	5.66%	6.60
	4%	%	8%	8%	6	%
	40	17	25	11		7

level (eg belong to the same country club or friendship group, etc).						
<b>CG26: The directors and CEO are independent of each other and are not childhood friends, or friendly on another social level (eg belong to the same country club or friendship group, etc).</b>	38.6 8% 41	13.21 % 14	28.3 0% 30	8.49 % 9	6.60% 7	4.72 % 5
<b>CG27: Directors discuss issues in a constructive and collegial manner at board meetings even if robust discussions take place.</b>	61.3 2% 65	23.58 % 25	10.3 8% 11	3.77 % 4	0.94% 1	0.00 % 0
<b>CG28: Directors are provided with all relevant business papers at least a week before a board meeting.</b>	58.4 9% 62	18.87 % 20	16.9 8% 18	2.83 % 3	2.83% 3	0.00 % 0
<b>CG29: The organisation only carries out clearly defined core business in accordance with the mission, vision and business plan.</b>	62.2 6% 66	16.04 % 17	16.9 8% 18	2.83 % 3	0.94% 1	0.94 % 1
<b>CG30: Over the past 5 years, the organisation has built up cash levels.</b>	27.3 6% 29	9.43% 10	12.2 6% 13	13.2 1% 14	12.26 %	25.4 7% 27

## Appendix I: The results for the 20 financial governance questions

	Stro- ngly agre- e	Agree	Some- what agree	Some what disagr ee	Di- sa- gr- ee	Stro- ngly disa- gree
<b>FG1: Signatories check invoices before cheques are signed off according to the conflict of interest policy.</b>	67.9 2% 72	11.32 % 12	15.09 % 16	1.89% 2	1.8 9% 2	1.89 % 2
<b>FG2: Financial documents are made available to board members for review at any time and are provided in a timely manner prior to board meetings.</b>	60.3 8% 64	12.26 % 13	21.70 % 23	3.77% 4	1.8 9% 2	0.00 % 0
<b>FG3: The organisation only engages in fundraising activities with the appropriate fundraising permits (authority to fundraise).</b>	55.6 6% 59	9.43% 10	20.75 % 22	5.66% 6	0.9 4% 1	7.55 % 8
<b>FG4: An annual audit is carried out or an independent Certified Public Accountant (CPA) thoroughly reviews the organisation's financials on an annual basis.</b>	13.2 1% 14	2.83% 3	2.83% 3	2.83% 3	13. 21 % 14	65.0 9% 69
<b>FG5: A new audit firm or a new CPA is appointed every 5 years.</b>	4.72 % 5	2.83% 3	5.66% 6	3.77% 4	13. 21 % 14	69.8 1% 74
<b>FG6: The CEO ensures that a few quotes are first obtained from service providers. The quotes are then compared and the most suitable quote chosen before the service provider is engaged for service.</b>	52.8 3% 56	15.09 % 16	24.53 % 26	1.89% 2	4.7 2% 5	0.94 % 1
<b>FG7: Quotes that are too expensive and are out of the regular payment for a similar service are refused.</b>	58.4 9% 62	13.21 % 14	22.64 % 24	1.89% 2	3.7 7% 4	0.00 % 0
<b>FG8: Financial documents are securely kept for at least seven years.</b>	66.0 4% 70	11.32 % 12	18.87 % 20	0.94% 1	0.9 4% 1	1.89 % 2
<b>FG9: The CEO and other key employees' remuneration are reviewed annually by the Board.</b>	46.2 3% 49	10.38 % 11	20.75 % 22	2.83% 3	6.6 0% 7	13.2 1% 14
<b>FG10: The organisation has a clearly articulated investment policy.</b>	12.2 6% 13	6.60% 7	8.49% 9	6.60% 7	10. 38 % 11	55.6 6% 59

<b>FG11: The directors have the knowledge, skills and ability to interpret financial reports.</b>	51.8 9% 55	11.32 % 12	25.47 % 27	4.72% 5	2.8 3% 3	3.77 % 4
<b>FG12: The organisation always meets its acquittal deadlines.</b>	52.8 3% 56	13.21 % 14	22.64 % 24	3.77% 4	3.7 7% 4	3.77 % 4
<b>FG 13: The organisation has not been on the verge of closing down in the last 5 years.</b>	51.8 9% 55	10.38 % 11	22.64 % 24	5.66% 6	1.8 9% 2	7.55 % 8
<b>FG14: The CEO has formal financial training.</b>	34.9 1% 37	8.49% 9	28.30 % 30	11.32 % 12	6.6 0% 7	10.3 8% 11
<b>FG15: The organisation has an annual budget. This is used to check variances of budget figures to actual expenses.</b>	47.1 7% 50	11.32 % 12	30.19 % 32	3.77% 4	0.9 4% 1	6.60 % 7
<b>FG16: The organisation has a 3-year budget.</b>	36.7 9% 39	8.49% 9	28.30 % 30	10.38 % 11	7.5 5% 8	8.49 % 9
<b>FG17: The organisation has a cash flow statement which is used to determine the financial standing of the organisation at any period.</b>	34.9 1% 37	11.32 % 12	32.08 % 34	10.38 % 11	2.8 3% 3	8.49 % 9
<b>FG18: Directors of the board do not receive any payments for services rendered to the organisation.</b>	53.7 7% 57	8.49% 9	27.36 % 29	3.77% 4	3.7 7% 4	2.83 % 3
<b>FG19: The Board receives the audit/financial report and meets with the auditor or independent CPA at least once before the AGM.</b>	10.3 8% 11	3.77% 4	2.83% 3	3.77% 4	11. 32 % 12	67.9 2% 72
<b>FG20: The Board identifies for the auditor a different area of operation each year for a more in-depth audit analysis.</b>	4.72 % 5	5.66% 6	0.94% 1	2.83% 3	12. 26 % 13	73.5 8% 78

## Appendix J: Case study questions

1. Please tell me about your organisation: its size, structure and objectives.
2. What are the reporting lines?
3. How did the previous board operate?
4. What are the problems you faced with the previous board?
5. What are some of the governance problems they had?
6. How did the things change for the better?
7. What are some of the things that the current board does well?
8. Do you think a code of conduct for director would have avoided this problem?
9. What are some of the code of conduct principles that you think is needed for small NFP organisations in Australia?
10. Do you think the following code of conduct principles are needful to be included:
  - Confidentiality
  - Transparency
  - Integrity
  - Declaration of conflicts of interest?
11. Is there anything else you would like to add?