

Discussion paper

Remuneration of Directors in the Not for Profit Sector

Prepared by Steve McDowell, reviewed by John Page

Purpose

1. The purpose of this paper is to outline the positives and negatives for director remuneration on not for profit boards.

Background

2. The not-for-profit sector represents a diverse range of public benefit entities.
3. The organisations are generally constituted either as a trust or incorporated society with the requisite deed or constitution defining structure and key governance requirements. Those documents should include policies in respect to remuneration and performance of directors.

Activities of Directors

4. For evaluating the pros and cons of whether directors should be remunerated in the volunteer sector, it is useful to assess what is the role and responsibility of a director. A list of director competencies particularly in relation to the boardroom are set out in appendix one. The key issues that will require director time and expertise are summarised as follows:

Accountability

5. The accountability to the organisation that a director represents is more than just to show up at a meeting. There are fiduciary responsibilities that sit with each director.
6. Although Incorporated Society law is presently silent on director duties that will change under the new legislation. Similarly, the current review of the Trusts Act may impact director obligations. In the absence of specificity, case law would indicate that the Companies Act should serve as a useful guide to obligations of directors.
7. Directors are now more accountable under health and safety legislation
8. Accountability also relates to the accessibility of each director to the organisation in general. It is commonly accepted practice that directors will be accessible to the Chief Executive. In smaller organisations directors may deal with senior staff on an advisory basis. In membership organisations there is generally an expectation of broader accessibility and accountability.
9. The level of accountability could be a significant deterrent to people considering director roles.
10. Another key question to consider is will an organisation get better outcomes because directors are being paid. There is debate both ways on this matter. Some argue that payment of any kind fundamentally changes the accountability relationship. Others argue that volunteers agree to serve on the basis of best endeavours and other than in rare cases cannot compete with rates for commercial directors.
11. Consideration of the politics surrounding remuneration is equally important given that the internal democratic processes of many NFPs may be disturbed by changing the voluntary

nature of the board and by external reaction from funders, major donors or the general public.¹

Responsibility

12. Directors are expected to act in a full governance mode (strategy and policy focused, forward-looking and allocating resources to enable the achievement of strategy) but at times move into a volunteer mode supporting the organisation through the Chief Executive to deliver on the ground services. If that moves beyond simple advice to paid service that needs to be carefully managed and declared.
13. The standard of performance and competency for not for profit board directors has changed considerably in the last five years. Volunteer boards have transitioned from being volunteers in many respects (unpaid, part time, well intentioned members) to necessarily working in a more professional manner.

Expertise

14. Membership organisations expect that the directors, either appointed or elected will have the necessary competencies to fulfil the director's role. Those competencies are often developed over many years and can almost be described as the individual intellectual property that a director brings to an organisation. The question is whether this level of expertise should be recognised through remuneration.
15. Peter Winneke, Head of Philanthropic Services, Myer Family Company discussed the issue of performance in an article the Pro Bono Australian News (26 March 2015) as follows: *Being on a NFP board is often more difficult than a for-profit board. You are likely to be tackling significant social issues with limited resources and few options to raise capital, and where outcomes measurement is difficult. With payment should come greater commitment to professionalise NFP boards, greater focus on outcomes and measurement of board performance. Payment would provide a stronger sense of contract. Shouldn't we demand the best board members for our NFPs? And pay them appropriately?*

Director role

16. There are many reasons why people put themselves forward to be the director of an organisation. It may include:
 - Giving something back to an organisation or to a community,
 - Where an issue has been identified that a person thinks the skills they possess could assist the organisation,
 - Seeking change particularly where there are concerns that personality sitting around the table or in the organisation,
 - Ego – the status of being a director,
 - The excitement of being involved in a profile organisation that has interesting activities in front of it.
17. At times people may seek a director's role where they see an ongoing opportunity for themselves to develop their own individual director's skills with a view to becoming a semi or fully professional paid director as a part or full time "job" role.

¹ Linda Lavarch, former Chairperson of the Not-for-profit Sector Reform Council, Pro Bono Australia News, 26th March 2015

Boardroom capability

18. The ability of individual board members and the board collectively to operate effectively and efficiently is an area that many struggle with. There is a clear need for directors to be strategy and policy focused and to be effective in board meetings. The capability of directors varies and can affect the ability of a board to work through a meeting in a clear and logical manner achieving quality outcomes rather than focusing on operational activities. Identifying and recruiting suitably talented directors is still a challenge for most boards.

Independent and membership elected directors

19. A key issue is the differentiation between independent directors and member elected directors. One of the potential expectations of independent directors is that they will be remunerated because they are bringing an independent view and their time to an organisation that they are not formally associated with. In other words, the time could easily be used elsewhere should remuneration become a tipping point as to whether independent directors join an organisation or not.
20. The question is whether independent directors alone deserve remuneration primarily because they are bringing independence to the organisation. That is likely to cause tension within the board and wider organisation.
21. Member elected directors also have an argument for recognition through some form of remuneration because they are giving their time over and above that of the general members to ensure that the organisation continues to function. One of the key concerns raised in recent board reviews is the lack of individual and collective assessment to establish the competence and capability of board members. This raises a question as to whether any organisation paying remuneration should therefore be required to undertake an annual director review process.

Officeholders

22. In considering remuneration there must be some discussion in respect to whether the Chair and Deputy Chair and, where in place, committee chairs should be remunerated in recognition of their responsibilities and leadership role. Likewise, should a President or figurehead leader that is a member of the board also be remunerated?

Changing Environment

23. In considering whether directors should be remunerated, another factor to consider is the environment they currently operate in and looking forward to the environment of the future. For example, the following activities may require significant increases in time, responsibility and skills:
- Lead up to hosting a world championship
 - Financial pressure and managing a medium to long term financial rescue operation
 - Membership drive
 - Strategic plan development
 - Major stakeholder engagement programme
 - Managing through an unstable board change process

Whether to pay or not to pay

24. The following assessment criteria may assist an organisation determine whether to pay remuneration to members or not:

- Number of yearly meetings
- Size of the organisation (members and budget)
- Can we afford to pay directors?
- Is the complexity of the organisation such that we need semi-professional directors?
- Would payments fit the organisational mission and values?
- Will the membership accept directors being paid?
- Can we attract and retain the right skill mix for the board without offering fees?
- Are there any legal implications for paying directors?
- How will the internal and external politics play out if directors are remunerated (justification for example)?
- Are we competing for appropriately skilled directors (particularly independent directors)?

Current practice in the sport and recreation sector

There are few sector organisations that remunerate the whole board. Some give the chair a stipend recognising the additional time required. That tends to be nominal (c\$10k).

NZRU pays its chair \$131k and directors each c\$50k (annual report 2017). The Netball report is silent although we believe directors are paid, Rugby League directors are paid, and the annual report notes a total cost of \$119k, similarly Aktive Auckland with a cost of \$92k. NZ Cricket's report is silent, but directors are certainly paid. We are not aware of other remuneration of the whole board in the sector although this may exist.

Current practice in the wider non-profit sector

This information was kindly provided by Strategic Pay and taken from the 180 respondents in their annual survey director remuneration in the non-profit sector. Where chairs are paid the range is \$20-\$40k, and the median is \$30k. For directors the range is \$4 - \$19k, and the median is \$12k

Strategic Pay are happy to provide information more specific to your situation.

www.strategicpay.co.nz

Conclusion

From a first principles point of view it would be ideal to remunerate directors where the complexity of the task warrants it. Simon Telfer of Appoint Better Boards favours this approach. Indeed, it may assist in attracting candidates with better skill sets, and it certainly changes the accountability dynamic to some degree. However, there are approximately 120,000 non-profit legal entities in Aotearoa NZ. Cost becomes a factor and it would be unfortunate to wash out the volunteer imperative. It is unlikely other than the two major codes that remuneration will ever approach market rates. There is no one answer, and the choice lies with the organisation.

Appendix one – Board Room Competencies²

Strategic thinking skills

Highest on the list of directorship skills is the ability to adopt a strategic perspective particularly an ability to look beyond operational issues and work towards a vision for the future.

An understanding of organisational structures and systems

Directors should have a basic understanding of how organisations should be structured and operated to deliver appropriate results.

Financial management

Every director should be comfortable with traditional financial statements, understand the current financial position, areas of risk and future financial requirements.

Knowledge of general legal issues

An understanding of the relevant legislation and regulatory environment within which the organisation operates.

Knowledge of the business of the organisation

Every director must accept a personal responsibility to remain up-to-date in their knowledge about the business and its environment, so this can be applied in the board's strategic decision making and performance monitoring.

Commitment to the organisation's Mission and Values

Because of its stewardship role all board members must demonstrate tangible commitment to the organisation's mission and values.

Meeting skills

When required an understanding of formal meeting procedure

A commitment to governing

Directors should understand the difference between governance and management.

Appropriate connections

For some boards, appropriate connections and networks are an essential director contribution although not all directors will bring such connections, and neither should they be expected to.

Appropriate contribution

A more universal expectation is that all directors will make an appropriate contribution through the specific knowledge they bring to the table.

² Sport New Zealand Nine steps to effective governance - building high-performing organisations
12 September 2017- Board room competencies