

Part 3

What NGOs Should Know About:

Corporate Governance

This document is a part of a four-part series of briefings developed by Dóchas in August 2006.

- > Part One outlines the changes in the legal environment of Development NGOs and describes some of the main implications for Dóchas members.
- > Part Two highlights current and future legal obligations of the Directors (Board Members) of Development NGOs under Company Law.
- > Part Three presents a number of recommendations on how Development NGOs can strengthen their corporate governance. The aim is to suggest ways in which NGOs can go beyond compliance with the legal minimum.
- > Part Four outlines current suggested practice in the area of financial accounting.

This document sets out how NGOs can review their corporate governance.

As part of its efforts to brief members on the various aspects of Charity Regulation and Legislation, Dóchas wants to use this document to provide a simple framework to allow member organisations to review their corporate governance requirements.¹

The Revised Combined Code on Corporate Governance² stresses the need for an individual organisation to “comply or explain” when determining its specific approach to corporate governance. Because NGOs vary enormously in scale, complexity, and range of activities, it is not possible for this document to cover all dimensions of corporate governance for a specific organisation. Nevertheless, it is hoped that the Guidelines contained in this document can inspire NGOs to critically assess their own performance and requirements.

The Guidelines are set out in two categories below:

- a) **Board Performance** and
- b) **Accountability.**

¹ The document draws on principles of corporate governance set out in the Hampel Report (1998), and on the composite guidelines set out in the Revised Combined Code. The guidelines from the Revised Combined Code have been significantly adapted here to take account of the reality and nature of NGOs.

² <http://www.frc.org.uk/corporate/combinedcode.cfm>

a) Board Performance – 4 Principles

The following four overarching principles are suggested in the area of Board performance:

1. The Board must understand that it has the dual strategic obligations to control the activities of the organisation, and to promote its operational success.
2. The Board must regularly review its mission to allow for adaptation as circumstances change.
3. The Board should primarily contain independent Directors, and contain within its Board membership the requisite skills and experience to enable the Board to control and promote the organisation.
4. The Board must determine its information needs, and insist that such information is provided to it by management in a timely and appropriate manner.

Principle No.1:

The Board must understand that it has the dual strategic obligations to control the activities of the organisation and to promote its operational success.

Rationale: The Board should be able to direct and control the actions of management towards delivery of the Board's strategic goals.

To these ends the Board must clearly identify those responsibilities which are exclusively within the remit of the Board, and which are clear and distinct from the responsibilities of management.

Principle No. 2:

The Board must regularly review its stated mission to allow for adaptation as circumstances change.

Rationale: It is necessary for the Board to review its stated mission periodically to take account of changes perceived in its circumstances, or to reflect changes in strategic direction determined by the Board. This will enable the organisation to be flexible in the way it operates, seeking and applying resources in whatever manner best serves the stated mission.

Principle No. 3:

The Board should primarily contain independent Directors, and contain within its membership the requisite skills and experience to enable the Board to control and promote the organisation.

Rationale: The organisation needs to be guided by Directors who have sufficient independence from the organisation to be capable of behaving objectively in managing Board affairs.

The Board will have to deal, inter alia, with the following dimensions:

- Determining the appropriate size and composition of the Board;
- Appointing only appropriate persons as Chairpersons;
- Filling Board vacancies in a manner which provides regular changes of personnel without damaging continuity of knowledge and experience;

- Inducting and mentoring new Directors;
- Preparing a continuing programme of professional development for Board members.

Principle No. 4:

The Board must determine its information needs, and insist that such information is provided to it by management in a timely and appropriate manner.

Rationale: To be able to perform effectively, a Board must receive appropriate information regarding the circumstances and performance of the organisation. Such prompt information will lead to good analysis by the Board regarding the state of the organisation, and will permit the Board to monitor management behaviour and performance.

b) Accountability and Reporting – 6 Principles

The following six overarching principles are suggested
in the area of Accountability and Reporting:

1. A Board Audit Committee should be in place.
2. The organisation must prepare Financial Reports that provide a balanced and clear assessment of its financial position and prospects, and which are prepared in compliance with accounting standards.
3. A Risk Management process must become a basic Board and management tool, to be capable of identifying all risks, both negative and positive, and enabling Board and management attention to be focused on requisite risk-related activities.
4. Formal systems of internal control must be installed, appropriate to the organisation, regularly reviewed by the Board Audit Committee, and carefully operated by management.
5. An appropriate internal audit function should be installed under the supervision of the Board Audit Committee.
6. The relationship between the external auditor and the Board must be understood and developed.

Principle No. 1:

A Board Audit Committee should be in place

Rationale: It is good governance practice today to appoint a committee of Board members as an Audit Committee. This committee will be responsible to the main Board for monitoring and supervising all accounting and control aspects of the organisation, as well as supervising the external and internal audit functions. It should also take responsibility for ensuring that risk management strategies are in place. Even in a small Board, it is imperative that such a Committee is established.

Principle No. 2:

The organisation must prepare Financial Reports that provide a balanced and clear assessment of its financial position and prospects, and which are prepared in compliance with accounting standards

Rationale: Apart from its compliance obligations, the organisation must provide information to the Board that enables it to see clearly the state of the organisation's affairs. This must be clearly defined as a management obligation. In addition, such reports must satisfy the needs of the various stakeholders.

→ See part 4 of this briefing series.

Principle No. 3:

A Risk Management process must become a basic Board and management tool, to be capable of identifying all risks, both negative and positive, and enabling Board and management attention to be focused on requisite risk-related activities.

Rationale: This is a necessary prerequisite for effective control. To be effective such a risk approach must be overseen and reviewed regularly by the Board. The outcome of all risk review exercises will guide the organisation in determining those aspects of the organisation that most critically need internal control mechanisms. This will also help the Board to determine what aspects of activities will require external assistance and review.

Principle No. 4:

Formal systems of internal control must be installed, appropriate to the organisation, regularly reviewed by the Board Audit Committee, and carefully operated by management.

Rationale: Organisation often gets completely immersed in providing the critical tasks required by its mission. These are operational in nature, are mostly critical and sensitive activities, and can distract the organisation from installing and overseeing internal control procedures. It is a critical function of management to maintain internal control systems, and the Board Audit Committee must oversee the management discharge of this responsibility. Where the resources of the organisation are incapable of maintaining necessary internal control standards, the Board Audit Committee must determine how any such shortcoming can be addressed.

Principle No. 5:

An appropriate internal audit function should be installed under the supervision of the Board Audit Committee.

Rationale: The establishment of an internal audit function is becoming a necessity in most organisations, even those which are small in terms of structure and activity. While this can be viewed as a voluntary matter in small organisations, the reality often is that stakeholders with such organisations are insisting on the existence of an internal audit function. Funding agencies are particularly demanding in this regard with NGOs. It is accepted in most situations that smaller organisations cannot afford a resident internal auditor, and that a suitable service provider can be bought in to discharge these internal audit obligations.

Principle No. 6:

The relationship between the external auditor and the Board must be understood and developed.

Rationale: It is important that the Board fully understands its responsibilities in relation to the statutory audit, and that it also understands the responsibilities of the external auditor, in law, in relation to the statutory audit and the compilation of the Annual Report and Accounts. In particular, the Board should oblige the external auditor to account formally to the Board and/or Board Audit Committee on the organisation's financial performance, and on the statutory audit outcomes. The Board Audit Committee must take responsibility for ensuring that the relationship between the external auditor and the organisation is fully developed into a meaningful partnership.

--o0o--

Written for Dóchas by
Ray McElroy
July 2006