

# Remunerating Not-for-profit Directors

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*NFP Insight*



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This paper explores the pros and cons of not-for-profit (NFP) director<sup>1</sup> remuneration, and offers practical tips for developing and implementing a remuneration policy. It is intended for those people involved in the governance of NFPs and charities, including directors and executives, as well as accountants, managers, staff and members.

## Introduction

NFP directors are spending more time than ever on their governance roles. That's according to the latest [Not-for-Profit Governance and Performance Study](#) from the Australian Institute of Company Directors' (AICD), which found over half of all surveyed directors spend more than two days per month on a single NFP board role.

Yet the vast majority of NFP directors remain unpaid, which begs the question: Should we remunerate them?

Traditionally, NFP directors have not been paid<sup>2</sup> and one school of thought says remunerating directors is fundamentally at odds with the *raison d'être* of the not-for-profit sector, and that board members should want to volunteer their time. Of course, it's entirely possible to advance the mission or purpose of your NFP, *and* pay your directors – the two things are not mutually exclusive. In fact, if remunerating the board *improves board performance* then such a strategy supports the organisation to achieve its aims.

But there's the rub: when does paying your board improve performance? If you pay your board members, will you necessarily get a better quality board?

Moreover, if you *do* decide to remunerate your board, how do you calculate the remuneration level – how much should you pay and how should you pay it? Do you have a policy for deciding who and how much to pay? Will all board members be paid equally? Should the chair of the board be paid a

premium? To what extent will your organisation evaluate board performance in order to assess value for money?

However, before answering those questions, you must determine whether your organisation *can* provide remuneration to its directors. That is, are there any legal and/or regulatory restrictions preventing you from paying board members? And does your organisation's constitution or governing rules preclude directors from being remunerated? If the answer is 'no' to both those points, then you're in a position to decide whether or not you *should* pay directors.

This Chartered Accountants ANZ Business Insight paper explores the pros and cons of NFP director remuneration, and offers practical tips for developing and implementing a remuneration policy. It is intended for those people involved in the governance of NFPs and charities, including directors and executives, as well as accountants, managers, staff and members. In this guide, where we refer to payments to directors we mean fees for service (rather than reimbursements for reasonable expenses).

This paper maintains that, while there's no one-size-fits-all recommendation when it comes to directors' remuneration, all decisions must be grounded in the strategic objectives of your organisation and the policy framework within which it is governed. With director remuneration, as with everything, keep your organisational strategy as your 'north star'.

## Step 1: Can we remunerate our directors?

Your organisation's capacity to pay directors rests on several factors. For instance, can your organisation afford to pay its directors?

If you determine your organisation has the resources to pay director fees, there are still questions to be answered regarding the relevant constitutional authority for payments.

1 In this paper, we recognise that those charged with governance of a NFP or charity can be termed directors or committee members, amongst other things. We have used the term 'director' with the intention of including all of these various titles.

2 In this paper, where we refer to 'payments' to directors we mean fees for service (rather than reimbursements for reasonable expenses).

The [Australian Charities and Not-for-Profits Commission \(ACNC\)](#) does not prohibit charities from paying their board members, “As long as payments to board members are in furtherance of the charity’s charitable purpose, permissible under the charity’s rules, and properly authorised within the charity.”<sup>3</sup> Charities that are registered companies with the Australian Securities & Investments Commission (ASIC) but that don’t include the word ‘limited’ in their company name must not pay fees to their directors.

In New Zealand, there are no fundraising laws or other regulations that might restrict payments to board members. In some states of Australia, however, fundraising laws may regulate payments to board members.

Some NFPs’ constitutions don’t allow for directors to be paid and you will need to check your organisation’s constitutional foundation documents carefully. Note: The constitution might categorically spell out that directors cannot be paid, or it may only be indirectly inferred. For instance, there may be a cap on how much can be spent on administration costs (where directors’ fees fall under administrative overheads).

In addition to the constitution, you must also check all other organisational agreements (including any agreements currently being negotiated). There may be funding arrangements in place (including contracts for future funding arrangements), or contracts for service delivery that preclude you from being able to pay your directors.

A further consideration are the tax impacts of paying directors. You should investigate what the tax implications are for your organisation if the payments are attached to the ‘profit’ of the organisation, or are considered to be a distribution (as opposed to a payment for services).

If your organisation doesn’t have a set policy on board remuneration then you will need to go through the appropriate (in-house) governance processes to have such a policy developed within the framework of your constitution. Create a remuneration policy, and then go about seeking the relevant internal and external stakeholder approvals if necessary.

#### Checklist: Can we remunerate our board?

- What does our organisation’s constitution say about payments to directors? Is it explicitly or implicitly disallowed?
- Can we afford to pay our directors?
- What do other organisational agreements say? Will director fees contravene existing (or future) agreements and/or contracts?
- What might the tax implications be if we pay our directors?
- Can we create an organisational policy on board remuneration?

Having determined that you’re allowed to remunerate your board, the next step is to decide whether or not you *should*.

#### Step 2: Should we remunerate our board?

##### The arguments for and against

###### Pros

**Recognition:** NFPs can be as large and as complex as any for-profit organisation – indeed they can be more so – meaning NFP directors must be just as skilled and committed as their corporate counterparts. In fact, many NFP directors also sit on corporate boards where they are paid – often substantially – for their contribution.

Rising governance expectations coupled with increasing NFP regulation, means the demands on NFP directors’ time are growing. Moreover, directors are taking on increased risk exposure as funding decreases in real terms in most sectors and clinical and other risks increase concurrently.

**Legitimacy:** Board roles not only impact those serving as directors, but also directors’ families and their employers. Board positions are a big time commitment. By paying your board members, even a token amount, it can validate the role in their minds, and in the minds of those around them. Thus payment of directors can legitimise the role for some.

**Competitiveness:** NFPs may have to compete with the commercial sector when it comes to attracting talent. Corporate boards offer directors’ fees as a matter of course, which can give them a competitive edge when it comes to attracting high calibre directors.

**Diversity:** Payment of directors may help establish a board with greater diversity. Some potential directors may be unable to participate in a board role unless they are remunerated. Such remuneration may assist in transport costs, family support expenses and other costs incurred by a director. As such, remunerating directors may also allow a broader cohort of potential directors to be recruited, thus increasing overall governance capacity.

3 Remunerating Charity Board members – ACNC. <https://www.acnc.gov.au/tools/guides/remunerating-charity-board-members>



Many (very capable) directors are excluded from NFP boards simply because they cannot afford to donate their time and skills. A *CA ANZ survey* found that, by far, the biggest obstacle preventing members undertaking pro bono work was ‘lack of time’.

Currently, the average age of NFP directors in Australia is 54 years old, with 77 percent of directors over 50 years old, and only five percent under 40 years old (AICD, *NFP Governance and Performance Study 2019*). It’s predominantly older people who can afford to participate, as the former assistant commissioner of the ACNC, Murray Baird, said in a recent podcast: “If you say: ‘This is only for volunteers’, it may confine you to retired people or people of independent means ... and what you’re really trying to get at is a diversity, and being able to remunerate fairly helps you in that regard.”

If you really want your board to be representative of the wider community, and you want to harness a broader, richer skillset – then you may need to consider paying your board members.

**Skills:** The remuneration debate hinges on the question: If you pay your board members, are you necessarily going to get a better quality board?

Anecdotal evidence from New Zealand organisation, Appoint Better Boards, suggests that the quality of candidates for board roles improves significantly when there is payment for the role, even when this payment is only nominal. Conversely, AICD data finds no correlation between remunerating NFP directors and the quality of their performance (see ‘Pay does not improve performance’, on page six for more information). You will need to give careful consideration to your own organisational context when assessing whether or not payments to directors will improve performance within your NFP.

How, then, can we best compensate NFP directors? Is it enough that board members are contributing to a cause they believe in? (Or that some may receive an honorarium?) Is it fair that the majority of NFP directors aren’t remunerated while their corporate counterparts are being paid, often for similar roles?

Ultimately, these are questions for each individual organisation to wrestle with.

## Cons

**Philosophical opposition:** As mentioned at the outset, some people believe paying the directors of a charity or NFP is fundamentally at odds with the spirit of the sector and that all of a NFP’s available resources should go directly to furthering the purpose of the organisation.

Of course, remunerating your board is likely to contribute positively to the purpose of the organisation where it attracts and retains higher calibre directors. Yet this is often a politically charged argument and you should approach it with sensitivity when asking: will the introduction of director fees contradict our organisation’s values?

**Accountability:** Accountability is a key question when considering board remuneration, particularly where the board is involved in making decisions about payments. Governance issues can be particularly relevant for NZ Charitable Trusts, which are not required to hold an AGM where payments could be approved.

### Personal liability occupational health and safety risk for paid directors:

Under work health and safety laws across Australia where they apply to the organisation, board members have a health and safety duty to employees and volunteers. A board member can be found personally liable for failing to act in accordance with that duty. Personal liability means that the penalty for any breach of the law applies to the individual rather than the organisation, however, an exception applies to volunteer board members acting in their capacity as volunteer board member. This means that a board member will not be found personally liable where they are a volunteer.<sup>4</sup>

However, paying board members may mean they can be personally liable as individuals for failing to carry out their duties in relation to work health and safety.

**Civil liability risk for directors:** Paying a board member could also mean they may be personally liable for injury, damage or loss to a person under civil liability laws, including in relation to clinical risk. Laws vary in scope across Australian states and territories, however, in general, they allow a person who is injured, suffers damage to property or financial loss to take legal action, and be compensated by the person who caused or contributed to that injury, damage or loss. State and territory civil liability laws include an exemption from personal liability for volunteer board members in certain circumstances.<sup>5</sup>

<sup>4</sup> Source: NFP Law website. [www.nfplaw.org.au/governance](http://www.nfplaw.org.au/governance)

<sup>5</sup> Source: NFP Law website. [www.nfplaw.org.au/governance](http://www.nfplaw.org.au/governance)

See the table on [pages 7–9 of this NFP Law PDF](#) for details on the specific provisions in each state.

Please note that civil liability laws in Australia are complex. Organisations may wish to seek legal advice when seeking to clarify the implications of paying (or not paying) directors. They may also want to consider taking directors and officers insurance cover. Further details about civil liability laws can be found on the [NFP Law website](#).

**19%** of surveyed NFP directors in Australia receive remuneration. This figure has remained relatively unchanged for the past six years.

Source: *The AICD NFP Governance and Performance Study* (July 2019).

### How much is enough? Remuneration policy

If you've decided to remunerate board members, how do you determine how much to pay them?

While there's no magic formula for determining pay rates, the key is to take a comprehensive, strategic approach to remuneration. Develop a policy that's tailored to your organisation and that takes into account your various stakeholders, the broader industry context and, perhaps most importantly, your capacity to pay.

An important question to ask, then, is: What resources are available? How much can we afford to pay our governing body?

Here, consider whether it's logical and prudent for all directors to be paid the same amount. Often a pool of funds is allocated for director fees, and these fees are divided according to each director's individual responsibilities. For instance, each board member may receive a flat fee for being a director, plus separate committee fees for each committee they are involved with. In this way, the amount paid is not tied to the individual but rather it's tied to their responsibilities.

Will your organisation try and compete with the private sector on a dollar-for-dollar basis? If so, how will you go about that? Industry benchmarking can be useful when determining a commercially comparable rate.

However, if your organisation can't or won't compete then the alternative is to offer a nominal fee. Yet the effect of nominal payments on performance and morale shouldn't be underestimated. The moment you start paying board members you're acknowledging their contribution in a very real, very tangible way, and you're demonstrating that the organisation values their time and their skills.

A nominal fee also legitimises governance positions, as explained above.

Ultimately, any decisions around how much to pay your directors come down to performance and value for money. As part of your remuneration strategy, consider how your organisation will assess board performance – both individual performance and the board as a collective. This should form the basis for your decisions.

Note: It's not uncommon for NFP board members to want to donate their salaries back to the organisation. It's a good idea to put processes in place for board members to donate their salaries seamlessly back to the organisation without tax (or other) implications to the organisation or the individual director.

Ultimately, whichever approach you choose, whether a commercially competitive rate or a nominal fee, it's essential you have a strategic remuneration strategy underpinning your decisions.

### Pay does not improve performance

It may sound counter-intuitive but Penny Knight MAICD, Managing Director, BaxterLawley says there's no correlation between remunerating NFP directors and the quality of their performance.

"There is a misconception that if you pay people, you'll get a better result," says Knight. "But it simply isn't the case.

"What we know – and the jury is *in* on this – is that pay is a factor in attracting someone to their profession; pay can even attract somebody to your organisation. But all the other aspects of working within your organisation will have a far greater impact on productivity than pay."

Here, Knight cites factors such as working conditions and staff morale.

**"In short: Do not expect better performance from your NFP directors because you pay them," Knight says.**

"What I tell people is that paying your existing directors will not suddenly improve their performance.

"If, however, you want to try and improve governance by recruiting new directors, then introducing payment for directors *can* have an effect. Once you start paying your directors, it often expands the number of applicants, meaning you'll have a bigger pool to choose from."

Having said that, Knight emphasises that good governance needs to be fit-for-purpose, and director remuneration should not be viewed as a quick fix.

"Just as your corner store doesn't have the same governance requirements as, say, Coles or Woolworths, there's no one-size-fits-all governance solution for NFPs."

Knight explains the AICD's 2019 *NFP Governance and Performance Study* shows NFP board fees vary in accordance with organisation size.

"Yet even within the very largest organisations with turnovers of more than \$100m, only 45 percent pay their directors," Knight adds. "The majority of NFP directors are still unpaid."

"The bottom line is: If you want to improve governance, you need to know what 'good' looks like for your organisation," Knight says. "You may find that you don't need to pay directors in order to achieve the level of governance you need.

"Certainly, paying people without having these strategic conversations is very likely to stretch your costs without necessarily producing any improvement."

**Penny Knight MAICD, Managing Director, BaxterLawley. BaxterLawley is responsible for the research underpinning the AICD's 2019 *Not-for-Profit Governance and Performance Study*.**

### Accountability and transparency

Accountability is vital for any not-for-profit or charity and so transparency is very important where your NFP chooses to pay its directors. Disclosure to all stakeholders is paramount.

ACNC Governance Standard 2 states: "Charities must take reasonable steps to be accountable to their members and provide their members adequate opportunity to raise concerns about how the charity is governed."

While the latest ACNC Legislative Review recommends, "greater disclosure of related party transactions and remuneration practices to improve public trust and confidence in the sector." It also states: "The disclosure of remuneration practices should only be required of large registered entities."

### Related party transactions

**Note:** The Annual Information Statement required by the ACNC asks medium and large charities:

- whether they have any related party transactions, and
- did they have documented policies or processes about related party transactions.

The ACNC states charities that prepare financial statements may also need to disclose remuneration payments as related party transactions. Related party includes key management personnel of a charity (defined in AASB 124: Related Party Disclosures). This may include a board member, or a close member of a board member's family.

Regardless of what type of accounts you prepare, you should be transparent by disclosing any director remuneration. Indeed, the AICD's *Not-for-Profit Governance Principles* recommend (7.4): "Directors' remuneration and other benefits, if any, are disclosed to stakeholders."

In addition to disclosure, we highly recommend you put in place a strategy to communicate your remuneration decision(s) to your stakeholders. You should be transparent about the fact you pay fees to your directors and will need to detail exactly how much you pay board members, and *why*.

It's important to educate donors, sponsors, and other stakeholders as well as the general public about your rationale for remuneration. This is key to stakeholder engagement and is essential if stakeholders are going to feel predisposed to donate to your organisation. It's also a matter of self-protection for the organisation and for the board. Regular and proactive communication around remuneration means all stakeholders will be aware directors are being paid. The annual report is an obvious outlet for this. So too are more regular communications updates from the board and the chair, such as e-newsletters or blog updates.

Transparency and accountability around remuneration is critical, whichever way your organisation chooses to communicate.

#### Sources of information/references

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#### Contributors

This NFP Insight has been prepared with contributions from the Charities and Not for Profit Advisory Committee, with thanks to:

David Gilchrist FCA

Craig Fisher FCA

Kerry Hicks FCA

Shaun Sargent FCA

With thanks also to Penny Knight MAICD, Managing Director, BaxterLawley.

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