

Floating the code

One could argue that a system of good governance is more necessary in the not-for-profit sector than any other, with an ever-increasing public appetite for accountability and transparency. But while the private sector's Combined Code of governance has been largely adopted and adhered to, will the very nature of the third sector make a universal code of governance all but impossible? Phil Cain finds out

Charity boards have thus far escaped the front-page scrutiny endured by their private sector counterparts, effectively following the collapse of Enron in 2001. Nevertheless, the sector is beginning to face up to the difficulties of establishing a universal system of good organisational leadership.

While there is little evidence of fraud in charity boardrooms on anything like the scale witnessed in private sector America, poor governance can still lead to organisational failure. In fact, according to

Paul Palmer, professor of voluntary sector management at Cass Business School, in every instance of the Charity Commission's investigations into failure, it has found that poor governance played a part.

And this makes sense. "If you don't have it right at the top, things flounder further down," says Pesh Framjee, head of management consultants Deloitte's not-for-profit unit. With poor governance comes "greater scope for fraud and waste of resources", he says.

In addition, says Palmer, the enormous variations in the size, aims and income sources of charities create "a big baggy

mess", which in turn makes governance far more complex.

One initiative that aims to address this issue among others, is the Governance Hub, a broad Home Office funded initiative to foster better governance. According to Mike Hudson, the Hub's acting head, it has four main aims: to increase the supply of trustees; to help develop the skills of existing trustees – particularly chairs, who he says are the key to an effective board; to create networks which will ensure chairs have sufficient support; and lastly, to make sure there is capacity in the system for boards to do their jobs properly.

The Hub recently published a voluntary code to help create some kind of sector benchmark for governance, which it

hopes will contribute to achieving this last objective. Charities will be actively encouraged to comply with or explain their reasons for departing from the new code, just as companies based in the UK have been encouraged to do with their Combined Code of corporate governance, published in 2003.

In large quoted companies, this practice has already become almost universal. But the Governance Hub has set no target for how many charities will explicitly benchmark their governance against the code, being content at present for 5,000 organisations to refer to it. "We are conscious that the code is a first draft," says Hudson, "and will be actively seeking feedback." An amended version is scheduled for December 2006.

As for the private sector and the near universality of adherence to the Combined Code, the main reason why companies are willing to toe the line is due to simple market forces, reckons Palmer. He points out that failure to adhere to good governance models means that equity analysts will downgrade a company's stock. This threat, however, is of obvious little consequence in the third sector.

This then begs the question of who will care as much, or have enough leverage, to make sure charities take heed. "Various stakeholders," says Neal Green, senior policy advisor at the Charity Commission. "Beneficiaries, the public at large, donors – people putting money in tins are concerned about this." These same people, of course, will not necessarily have the time and know-how to assess a charity's corporate governance policies, but "it is a process of education," says Green. "We want to raise awareness generally."

It is this set of stakeholders who are the main drivers for adoption. And in reality, like with the private sector, the incentives to do so effectively come down to cash. "This definitely lies with the funders and donors," says Rona Howarth of Northumberland-based consultants Governance Works, who highlights how large grant-making bodies, such as the National Lottery, make some of the most rigorous enquiries into the running of organisations they consider for funding. "Funders and support agencies are becoming more aware of this, and all are asking questions about corporate governance," she says.

Professor Palmer, however, is less certain about the influence or scrutiny of funding bodies: "I am not aware of a funding body that has the right degree of monitoring or accountability," he says, adding that a good example of the kind of questions funding bodies should be asking are those found in the Charity Commission Summary Information Return for charities of over £1 million. Deloitte's Framjee, meanwhile, says the Commission's Hallmarks of a Good Charity provides a useful guide to how to recognise a well-run charity.

The Commission's requirement for charities to produce a new Statement of Recommended Practice (SORP) will also play a key part in instilling good governance. To help charities understand what is required, the regulator in conjunction with the Charity Finance Director's Group has produced a book of examples of how the new accounting principles might be implemented in various types and sizes of organisations [though at least one major charity has already adopted the new SORP – see page 50]. The

hope being that this will help ensure that information is flowing in a way which allows boards to make effective strategic decisions.

That is all well and good particularly if combined with the Code. However, there are still some who have their doubts about the Code and question whether it is possible for such a diverse sector to adopt a universal set of governance principles. "The thing is that there are too many variables for a single code," says Governance Works' Howarth. "A huge amount depends on the size, scope and scale of an organisation. No-one is policing this, and it is hard to see that there ever will be."

Anticipating this problem, the Hub has produced two different versions of the code – one for big charities and another for smaller organisations. "The headings are the same, but the way they are implemented is different," explains Hudson. While "big" and "smaller" may sound ambiguous, it is a little more clear cut than that. Charities need not be enormous to make the bigger code more relevant: "The break point is the recruitment of the first employee," says Hudson.

Employing staff is another major governance concern as with it comes a raft of new legal responsibilities, including one of the most contentious themes in charity governance: that charity law does not allow a paid member of staff to be a member of the board, unlike in the private sector where chief executives and other senior executives usually have a vote.

As the Charity Commission's guidance on the matter states: "Trustees cannot receive any benefit from their charity in return for any service they provide to it unless they have express legal authority to do so," – a divide that Professor Palmer likens to that which once existed between unpaid 'gentlemen' and paid 'players' in cricket.

Charity governance experts agree that this division of legal responsibility has in some cases led trustees, unwisely, to ignore the importance of gaining the input of senior managers into significant strategic decisions. "Sometimes trustees don't delegate responsibility, but abdicate it," says Deloitte's Framjee. A problem which is exacerbated further by the very nature of the trustee role meaning board members are often not involved on a day-to-day basis with their charities.

Another common problem is that boards are too big to act as effective decision-making bodies. Recommendations for the optimum size of a board vary from between nine and 12 members. "But many still have 30 to 40 and I know of one that has 200," says Framjee. A good example to work towards, he says, would be for a smaller charity to create a board of eight members when it hires its first employee, and for larger charities, management should be an integral part of the board, with numbers swelling the total to anything up to 15.

There is already movement in the right direction according to Hudson, "One of the trends of the last few years is that larger organisation are reducing size of boards and smaller ones increasing it." However, Professor Palmer believes this does not go far enough and that fundamental governance problems of the sector will only be resolved by amending the law to address the legal divide between board and management. As it stands, there is nothing on the cards which will accomplish this.