PART 6: SECTOR SUPPLEMENTS
SUPPLEMENT FOR NON-PROFIT ORGANISATIONS

1. NPOs – the macro view and benefits of corporate governance

Non-profit organisations have an increasingly important role in developing economies. These roles are articulated as follows by the Worldbank\(^1\):

- providing goods and services - especially meeting needs which have not hitherto been met by either the state or by the private sector
- assisting the government to achieve its development objectives - in particular through contributing skills for which NPOs have comparative advantage, such as public information, education and communications campaigns, or providing information about the situations and needs of particularly vulnerable groups
- helping citizens to voice their aspirations, concerns and alternatives for consideration by policy makers, thereby giving substance to governments’ policies regarding freedoms of association and speech, and
- helping to enhance the accountability and transparency of government and local government programs and of officials.

Taking into account the critical role that the NPO sector fulfils, it is in the interest of the whole of society that this sector should thrive.

Good corporate governance contributes to the success of an NPO by assisting with achieving better operational results and access to funding, grants and loans or access to these on better terms. An NPO having good corporate governance also adds to its credibility and therefore the impact of its activities and advocacy.

2. Scope

An NPO can be incorporated in various forms including as a not-for-profit company, charitable trust, voluntary association, club or fund. Social enterprises refer to organisations that fulfil social or environmental needs and could be set up as for profit entities that operate as private companies, sole proprietorships, business trusts or partnerships\(^2\). This supplement addresses non-profit legal forms but is not limited to organisations that have been granted NPO status in terms of the Non-profit Organisation Act.

Public benefit organisations (PBOs) refer to the tax exempt status of certain activities of organisations granted by SARS and not their form of incorporation. (For-profit organisations do not qualify for this status.) This supplement applies to both PBOs and other NPOs.

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3. Terminology

In order to apply the King IV Code to NPOs without having to repeat it in its entirety, it is necessary to explain how the terminology used in the Code could be interchanged for terminology applicable to NPOs.

For NPOs that are companies references in King IV to ‘governing body’ should be understood as board and ‘organisation’ as company. For NPOs not incorporated as companies, King IV Code references to the ‘organisation’ it should be read as the trust, voluntary association, fund or other terminology that would be applicable.

‘Shareholder’ should be read as the member of the NPO in instances where it is incorporated as a not for profit company with members. Where the NPO is not incorporated as a company those practices that refer to shareholders should be applied to donors as the providers of capital to the NPO.

In this supplement the collective noun ‘NPO’ or ‘organisation’ is used as well as the terminology ‘governing body’ and ‘member of the governing body’.

The use of ‘corporate’ such as in ‘corporate governance’ is meant to refer to the governance of organisations that are incorporated to form legal entities separate from their founders. ‘Corporate’ does not only denote a company or for profit enterprise but all forms of incorporation whether as company, voluntary association, retirement fund, trust, legislated entity or others. The term corporate governance is used to differentiate it from other forms of governance, for example national or political governance.

4. Applying the practices in the King IV Code to NPOs

Certain recommended practices in the King IV Code are referenced in this supplement to illustrate how they could be customised to meet the needs and requirements of NPOs. It would be inaccurate to conclude that those practices in the King IV Code which are not dealt with specifically in this supplement are not applicable to NPOs.

The essence of King IV as represented by its outcomes and principles apply to NPOs with the necessary adaptation in terminology and are repeated below for ease of referencing.

4.1 Proportionality considerations

NPOs include a continuum of organisations that vary largely in size and form of incorporation and appreciating this is important when interpreting King IV for application to NPOs.

The principles of the King IV Code apply to all NPOs. Differences in the implementation of corporate governance are accomplished through proportionality – that is, adapting the practices according to where the organisation is in its growth cycle and its size, resources and the complexity of strategic objectives and nature of operations. Implementing governance practices is not an end in itself and NPOs should ensure that corporate governance is harnessed for achieving strategic objectives and overall positive outcomes in terms of effects and impacts on the capitals.
The following serves as an illustration of how recommended practices could be scaled in accordance with proportionality considerations:

Where it is recommended in the Code that certain functions should be established – for example risk and opportunity, technology and information, compliance or assurance, a senior employee could be designated responsibility instead of implementing a fully-fledged function. If proportionality considerations warrant it, further scaling could be achieved by allocating part-time responsibility for the function to such an employee. Outsourcing of functions is another alternative and so is sharing functions and resources with affiliated organisations.

A recommendation that a committee of the governing body be formed could, if justified by proportionality considerations, be replaced by having the governing body carrying out the functions normally fulfilled by such committee. In the alternative the governing body could delegate without abdicating accountability to one of its members to investigate, consider and prepare submissions for recommendation and consideration by the full governing body.

Where the Code recommends that a formal policy be established, it can be accomplished by reducing to writing a few guiding criteria and processes and by continually developing the document as learning evolves. The benefits of being intentional and devoting the necessary consideration to putting policies and structures in place should not be underestimated. Doing so clarifies thinking and ensures alignment of understanding amongst all those whom the policy affects.

Applying proportionality in respect of the practices is subject to it giving effect to the principles. Refer to Part 3: Application of King IV practices for more guidance on proportionality.

4.2 Chapter 1: Leadership, ethics and corporate citizenship

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<thead>
<tr>
<th>OUTCOME: ETHICAL CULTURE</th>
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<tr>
<td>Principle 1.1: The governing body should set the tone and lead ethically and effectively.</td>
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<td>Principle 1.2: The governing body should ensure that the organisation’s ethics is managed effectively.</td>
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<tr>
<td>Principle 1.3: The governing body should ensure that the organisation is a responsible corporate citizen.</td>
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As is provided for in Principle 1.1, the governing body should set the tone and lead ethically and effectively. The values of accountability, responsibility, fairness and transparency exemplify ethical leadership and should be the cornerstone upon which any enterprise is conducted regardless of size and nature of operations. Thus sound governance and leadership start with a focus by the members of the governing body on their own - individual and collective - character and behaviour.
The legal duties of members of the governing body of an NPO are as a matter of law owed to the organisation itself and not the party or constituency by whom the member is appointed. These legal duties stand regardless of whether members of the governing body of an NPO act pro bono or for a minimum fee.

A governing body whose members are appointed as representatives of constituents, donors or other stakeholders of the NPO, should be especially proactive in managing potential and actual conflicts. Conflict of interest exists when there is tension between multiple competing personal and financial interests. This usually manifests in the entanglement of the private and professional interests of an individual. Examples of typical conflicts in an NPO environment include community members being the beneficiaries of the output of the organisation’s efforts and also serving on the NPOs executive or governance structures; the appointment of relatives and friends as employees or paid consultants or suppliers. The following practice in Chapter 1 under Principle 1.1 should be implemented in this regard: “Conflicts of interest (whether actual or perceived) should be disclosed to the governing body in full detail at the earliest opportunity, and then managed as determined by the governing body subject to statutory requirements. Conflicts of interest that cannot be managed must be avoided.”

In addition to setting the example through its own character and behaviour, the governing body should also ensure that the ethics of the NPO is managed effectively in accordance with Principle 1.2.

By virtue of fulfilling social, community and environmental needs, acting as a collective voice and holding others responsible, NPOs are an integral part of the societal dynamic. As such NPOs are corporate citizens and should look at applying the recommended practices pertaining to responsible corporate citizenship under Principle 1.3.

4.3 Chapter 2: Performance and reporting

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<thead>
<tr>
<th>OUTCOME: PERFORMANCE AND VALUE CREATION</th>
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<tr>
<td>Principle 2.1: The governing body should lead the value creation process by appreciating that strategy, risk and opportunity, performance and sustainable development are inseparable elements.</td>
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<td>Principle 2.2: The governing body should ensure that reports and other disclosures enable stakeholders to make an informed assessment of the performance of the organisation and its ability to create value in a sustainable manner.</td>
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**Strategy, implementation and performance**

Principle 2.1 of the King IV Code deals with strategy, implementation and performance. The constitution of an NPO outlines its envisaged contribution for environmental, public or social benefit. This is congruent with King IV advocating that organisations perform and create value within the triple context of the economy, society and the environment. It requires the balancing of priorities by the governing body so as to remain financially viable as well as delivering on environmental, public or social objectives.
In the interest of long term viability, it is important that an NPO has clarity about its strategy and its business model. The Department of Social Development Code\(^3\) specifically highlights three major responsibilities of the leaders of an emerging NPO to ensure survival and growth. Firstly, it needs to ensure that its service programme is meeting the community needs or problems effectively and efficiently. Secondly, it should ensure it establishes a reliable and sustainable support base in order to fulfil its work. Lastly, it should put procedures in place to ensure the careful and accountable handling of all organisation’s resources and programmes.

**Disclosure and reports**

The application of the disclosure practices recommended in the King IV Code may vary from NPO to NPO depending on size, resources and complexity of strategic objectives and the nature of operations and impact of business. Meaningful disclosure is the mechanism by which the governing body of an NPO is held accountable. The practices with regards to disclosure and reports as under Principle 2.2 should be considered by NPOs as a means for meaningful communication and to demonstrate accountability.

The G4 Global Reporting Initiative, Sector Disclosure for NGOs\(^4\) highlights some overarching issues specific to the NPO sector with regards to reporting and disclosures, namely:

- “demonstrating publicly that their operations are consistent with the values they advocate.”
- “transparency of the governance process and its relationship to an organisation’s mission and vision is seen to be of particular importance by … key stakeholders.”
- “evaluating program effectiveness”.

### 4.4 Chapter 3: Governing structures and delegation

**OUTCOME: ADEQUATE AND EFFECTIVE CONTROL**

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<tr>
<th>Principle 3.1: The governing body should serve as the focal point and custodian of corporate governance in the organisation.</th>
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<tr>
<td>Principle 3.2: The governing body should ensure that in its composition it comprises a balance of the skills, experience, diversity, independence and knowledge needed to discharge its role and responsibilities.</td>
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<td>Principle 3.3: The governing body should consider creating additional governing structures to assist with the balancing of power and the effective discharge of responsibilities, but without abdicating accountability.</td>
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<td>Principle 3.4: The governing body should ensure that the appointment of, and delegation to, competent executive management contributes to an effective arrangement by which authority and responsibilities are exercised.</td>
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<td>Principle 3.5: The governing body should ensure that the performance evaluations of the governing body, its structures, its chair and members, the CEO and the company secretary or corporate governance professional result in continued improved performance and effectiveness.</td>
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\(^3\) Department of Social Development’s Code of Good Practise for South African Non-profit Organisations (2001)  
\(^4\) G4 Sustainability Reporting Guidelines – Sector Disclosure for NGOs (2013)
Role of governing body
In accordance with Principle 3.1, the governing body is the focal point of corporate governance. The governing body of an NPO tends to emerge from the circumstances that gave birth to the organisation. As the nature and structure of the organisation changes and grows, so the governing body finds itself faced with changing challenges. At any stage of the organisational life cycle it is important for a governing body to be clear on how best to lead and provide direction.

In the King IV Code the overarching leadership and governance role of the governing body is summarised under Principle 3.1. The Independent Code for NPOs echoes this by specifically providing 6 key areas a governing body should focus on in order to demonstrate the exercise of effective leadership. They are:
i) a clearly defined vision, purpose and values; ii) ensured commitment to accountability and transparency; iii) monitoring fundraising and ensuring sustainability and risk are monitored; iv) constructive collaboration and synergy; v) maintaining a board and other governance structures; and vi) upholding procedural governance.

Composition of governing body
Principle 3.2 provides for the balanced composition of the governing body. There is no optimum size and best practice composition for the governing body of an NPO. There may be statutory requirements and other considerations, such as where the NPO is in its growth cycle.

Members of the governing body should have the required knowledge, experience and skills to govern the NPO effectively. Where members of the governing body of an NPO are appointed as representatives of constituents, donors or other stakeholders it is challenging to achieve the balance of skills, experience, diversity, independence and knowledge needed for the governing body to discharge its role and responsibilities. A formal process that is in place for appointments to the governing body will go some way in ensuring that the composition requirements of the governing body are identified, that the requirements are communicated to those who are responsible for nomination and election and that candidates are properly vetted. The practices recommended in support of Principle 3.2 are helpful in this regard.

In order to overcome resource constraints and the inability to pay market-related fees for the services of professional members of its governing body, an NPO should collaborate with professional bodies in its search for governing body members. Many experienced professionals are prepared to serve their communities through sitting on the governing bodies of NPOs for no or minimum fees.

Committees of the governing body
The establishment and delegation to committees of the governing body as provided for in Principle 3.3 are subject to considerations of proportionality.

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5 The Independent Code of Governance for Non-profit organisations in South Africa.
Delegation to management
The mark of an effective and maturing non-profit organisation is one where governing body members do not get involved in the day-to-day running of the operations, and relationships with staff, or the functions of the CEO. The practices under Principle 3.4 are pertinent in this regard.

Performance evaluations
Principle 3.5 and its supporting practices in relation to performance assessments are applicable to NPOs.

4.5 Chapter 4: Governance functional areas

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<thead>
<tr>
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<tr>
<td>Principle 4.1: The governing body should govern risk and opportunity in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.</td>
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<tr>
<td>Principle 4.2: The governing body should govern technology and information in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.</td>
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<tr>
<td>Principle 4.3: The governing body should govern compliance with laws and ensure consideration of adherence to non-binding rules, codes and standards.</td>
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<td>Principle 4.4: The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the creation of value in a sustainable manner.</td>
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<td>Principle 4.5: The governing body should ensure that assurance results in an adequate and effective control environment and integrity of reports for better decision-making.</td>
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The recommended practices under Principles 4.1 to 4.5 should be interpreted and applied in conjunction with the relevant legislative and regulatory provisions. Where NPOs are not able to implement the recommended structures and functions due to capacity and resource constraints, it is recommended that a shared services model be considered or that practices be applied on proportional basis.

4.6 Chapter 5: Stakeholder relationships

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<tr>
<th>OUTCOME: TRUST, GOOD REPUTATION AND LEGITIMACY</th>
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<tr>
<td>Principle 5.1: As part of its decision-making in the best interests of the organisation, the governing body should ensure that a stakeholder-inclusive approach is adopted, which takes into account and balances their legitimate and reasonable needs, interests and expectations.</td>
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<tr>
<td>Principle 5.2: The governing body should ensure that the organisation responsibly exercises its rights, obligations, legitimate and reasonable needs, interests and expectations as holder of beneficial interest in the securities of a company.</td>
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6 Department of Social Development’s Code of Good Practice for South African Non-profit Organisations (2001)
Principle 5.1 addresses stakeholder relationships. Some NPOs have shareholders or members and others have donors or funders that are the primary providers of capital to the NPO. Other stakeholders include employees, regulators, media, partners, beneficiaries, communities, suppliers and creditors.

The recommended practices under this principle assists with establishing stakeholder relationships that results in the governance outcome of trust, good reputation and legitimacy which is critical to the long term viability of the NPO.

Additional guidance is to be found in Section 4 of the G4 -SRG – Sector Disclosure for NGOs (2013) which deals with stakeholder engagement and makes some recommendations for participation of affected stakeholders in the design, implementation, monitoring and evaluation of policies and programs.

Principle 5.2 and its supporting practices are applicable to those NPOs that are investing or funding other organisations.

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7 G4 Sustainability Reporting Guidelines – Sector Disclosure for NGOs (2013)