

7. Financials

Speaker Key:

EL	Ellen Leabeater
DK	David Knowles
PB	Phil Butler
PC	Patricia Carroll

EL Welcome to the Community Colleges Australia podcast on board governance. I'm Ellen Leabeater. This episode is all about managing and building finances. You'll learn why profit isn't a dirty word, and how your board can get involved in fundraising.

Joining me is Phil Butler, not-for-profit sector leader with the Australian Institute of Company Directors, and David Knowles, partner at Koda Capital.

First up is Phil Butler, talking about how the standards for not-for-profits have changed over time.

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PB What we've really noticed with the not-for-profit sector, is some great diversity across the sector about their perspectives around financials. I think if you went back even 40 or 50 years, many viewed not-for-profits as running on the smell of an oily rag, generally with volunteers, and that they would have this make-do attitude.

Now we've got much more complex in our society, and the expectations on not-for-profits have never been greater. And to do that, to make those organisations work, they actually do need to have financial sustainability. They need to have that security to know that they can continue to achieve the things that they are set up to achieve, whatever their purpose might be.

EL One of the themes that has come up, is that not-for-profit is a bit of a misnomer, because you are allowed to make a profit.

PB Correct. In the 2016 not-for-profit governance study, we really made that as a very strong point. Then, Commissioner Susan Pascoe at the launch said, profit is not a dirty word.

And as I travel Australia, it's really interesting to see the different perspectives with regard to profit. Many organisations are very comfortable to talk about making a profit, to build up financial reserves. And yet others are really concerned about the profit word. They might use a word like surplus, or a small margin, but they feel uncomfortable about making a profit.

EL Why are people uncomfortable with the word profit, and making a profit?

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PB I think it goes back to, perhaps that older perspective of what the sector should look like. That the concept of people being paid for their services is often also thought of or being paid, you know, I won't say substantial amounts of money, but market rates of money, still perhaps viewed in the society as, well, aren't they just out there doing good things?

But we know that organisations do need to make a profit, because otherwise, they won't build up those financial reserves that they will need for their ongoing achievement of their purpose.

EL On the financial reserves, what are financial reserves, and how much should not-for-profits be keeping in the bank?

PB That's a really interesting one. The ACNC did release some guidance on that last year, but even with that, it's... it is a bit vague.

But perhaps I'll use my perspective, is that organisations should be thinking about the sorts of money that it would take for... if they suddenly ceased to be receiving... however they are getting their funds in, how would they wind up the organisation so that their employees receive the appropriate benefits that were owed to them, that all of the lease payments, all the commitments that had been made would be paid out?

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Now, often, that comes up to a figure of somewhere between six months' to a year's worth of revenue that's required to do that sort of payment. So, it'll be up to each board to look at that from their own perspectives about what are the commitments that they would need to make.

EL If you are, say, taking a risk with a new endeavour, are you... should you be digging into those reserves? Are there exceptions to the rule when you can dig into your reserves?

PB There's always exceptions to every rule. That's the beauty of governance, that's the beauty of organisations doing things. So, what most organisations will do, will have a conversation around that. So, let's say there is a real innovation they want to try, they might say, well, let's take a component of our reserves to use for that purpose.

Now, whether that's 5% or 10% or whatever, it'll be up to the organisation to consider that. What we also see organisations doing, is saying, well, let's put away sufficient money not just to cover our commitments in the worst times, but also knowing in five years, we might need to upgrade our IT or our... whatever it might be. And they actually put that money aside as part of those general reserves, knowing that they will be used at some point.

To me, the critical part is that the board makes the decision, has those conversations and records those conversations so that everyone is aware about what the purpose is in making that profit and building up those reserves.

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EL From your perspective, what's the most important thing that a board should know about finances?

PB So, there's the perspective from the individual, and that is, as an individual director, I want to make sure that the organisation is not trading while insolvent. Because I have got personal liability, potentially, once the organisation is trading while insolvent. So, I want to make sure that the organisation is solvent. That's probably the number one. And, you know, that's somewhat of a risk-averse approach.

One of the great things that's come up in recent times that will assist, particularly companies limited by guarantee, is that, there's been some changes happening with regard to safe harbour legislation. Which in the past, basically meant that as soon as you got a sniff of being insolvent, you called in the administrators.

We're still going to see this play out a little bit further, but it looks like, with the new safe harbour legislation, that was only passed back in September, early October, is it gives directors a little bit more of an opportunity to trade out of trouble. So that they can bring in some expert advice to assist them when they think they are getting close to the line, rather than immediately closing down the business.

What I probably want as number two is to be thinking about, are we in a financial position, and will we be in a financial position to achieve our purpose? And if the answer to that is no, then what are the implications for that? What are we going to have to do to meet that need of achieving our purpose?

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Once you've got sort of through those couple of questions, I think it then gets a little more of the complex discussion. Have we got the appropriate level of reserves? Have we got too much in the bank? We're not spending it on services. And each organisation will be very, very different with that regard.

EL What does too much in the bank mean? Surely that's a good thing?

PB Some member organisations are often having this conversation. Because their members are paying their money each year, and they've built up money in the bank. Members could be saying, well, hang on, couldn't those funds be better used in delivery of services?

And that's where it's really important to have that transparent, open conversation with members as about, what is our target on building up reserves? And, when we've got those level of reserves, what are we going to use them on for our organisation?

EL So, how important is the treasurer?

PB So, the role of the treasurer, again may be defined within your legal structure. So, if you're an incorporated association, it may be compulsory for you to have a treasurer role. My preference, though, is that the treasurer should not be viewed as the only person that keeps an eye on the finances.

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And I've been a bit horrified on some of the boards I've been on, that that tends to be the case. That everyone else is focused on the things that the organisation is doing, and doesn't delve deeply enough into the financials of the organisation.

EL So the financials come across your desk, and you just kind of flip the page, is that what happens?

PB Yes, and you say, hey, treasurer, is everything okay? And the treasurer nods wisely and says, yes all is fine. Well, you need to do some further investigation than that. And I think it's critically important for all directors to do that.

They don't need to have a deep knowledge of accounting, but they do need to know some of the questions to ask the treasurer, to make sure that, yes, we are as financially viable as the treasurer might be saying.

EL What about communicating profit? Who does your profits and your reserves need to be communicated to?

PB In terms of your financial statements, you'll need to make sure that, first of all, that they are accurate and appropriately reported in your annual report and out to members. So, that's the accounting side to it.

But the other critically important part is how do those reports get communicated to the broad range of stakeholders? Whether that be members, donors, users of your services, or whatever.

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And my take on that is, you make sure that that reporting is as transparent as possible, and clearly links to the organisation's purpose. So, why have we got 10 million dollars in the bank, or why have we got 50 dollars in the bank, this is the rationale for why we've got that amount of money, and this is the rationale for why we have got this target for our profit next year, and this is what we achieve for our profit in the previous financial year. And, each organisation will be different in that respect.

EL Phil Butler from the Australian Institute of Company Directors. And you can hear more from Phil in the next episode in this series, on engagement.

David Knowles joins me now. He's a partner for Koda Capital, and you may have already heard him on previous episodes, speaking about board effectiveness, and the importance of having a purpose.

In this next interview, David talks about how we need to value the money makers in not-for-profits.

What about raising money? Whose responsibility is that?

DK It differs in every organisation, and you'll have, potentially people who are paid to go out and raise funds for the organisation. I think we're seeing a professionalisation of fundraising in Australia, and I think it's really important that we do.

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And I say that because I think for too long it's been undervalued as a role. And the reason I say that, is because my 28 odd years in the for-profit, you know, financial services industry, has taught me that usually, the people who go out and get the money, the people who earn the revenue, are the best supported and often best-paid individuals in the firm.

That's not often very true, or hasn't been until now in the non-profit sector. But why is that? That money is the lifeblood of the organisation just like it is in the for-profit sector. So, those people need to be supported. But they, more than that, in the non-profit sector, need to be supported in an active way that means personal involvement, right?

So, what I mean by that is, again, coming back to the for-profit sector, those people that earn the revenue are well-paid, well-supported. But they're also expected to go out and do it. In the non-profit sector, I don't think it often works that way, because organisations don't have the luxury of the resources to allow that.

So, what they need to do, is supplement that where the executive team get directly involved and support the fundraisers, if there are a separate team of fundraisers. And, in the context of our conversation, where we're talking about boards, and often the boards need to get involved.

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Because often, funders, be they government or philanthropic, expect to deal with the decision makers with the nice titles. So, they will want to see and be engaged by, and be courted by those individuals, because of who they are in the organisational structure.

And a fundraiser might not be able to get them to become a supporter, or as much of a supporter as they have the potential to be, and therefore it's a team sport. The board, the leadership team and the fundraisers all need to work together as a team.

EL What are the common fundraising activities the board members will typically get involved in?

DK Common in the first place is probably not... I understand the way you mean it, but I don't think it's that common for board members to get involved. Not that common, because...

EL Should they be getting more involved?

DK Well, I'm arguing that they should. I think there's an active role whatever it happens to be, for all board members. Because funding the organisation and looking after the supporters is so important, right?

I don't think everyone has to raise money, some people will have contacts, some will have skills, maybe it's a marketing skill, a branding skill. Some will have contacts as well as money. Different people will bring different things. But I think because of the organisation, everyone has a role to play.

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There'll be some exceptions of course, and you might have non-profits that are so big and so well-resourced and look so much like for-profits that this doesn't really apply to them.

But I'm talking about the rump of the non-profit sector in Australia. There is an active role. The key is that everyone has a role to play. It doesn't have to be the same role. And the role may change from time to time.

The very important thing in my view is that there is only one chance to get that right, and confirm with people that they have a role, and what that role is. And that's when they're recruited.

Because if you shift the goal posts on people and say, we'd like you to come in because you've got wonderful skills and experiences, and they'll be very useful to us on our board, and then you say after a year, by the way, you have a fundraising target, and we expect you to go out and introduce us to five people and raise X hundred thousand dollars, then that's not going to go down very well. And it's probably not very fair.

So, the onboarding process and the recruitment process are critical, if you're going to get people to accept and understand their role.

EL So, if people do have that expectation, and they know going into it that they're meant to fundraise, is it a matter of using your personal networks, is it showing up at the sausage sizzle or what exactly are they expected to do?

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DK It's all of those and more. It comes down to what the organisation needs, okay? And what the individuals personally can bring. And so, one person might sit at the table and say well, I'm very happy to be involved, and I'll be there at the sausage sizzle and I'll rah, rah, rah, and you know, get people excited.

The next person might say, I have contacts that will be very useful to the organisation, and I'm happy to make a certain number of introductions. The next person might say, well, I am lucky enough that I have the capacity to give funds myself, and I'm going to make a contribution, like that.

So again, I'm reinforcing the point that it's different for everyone, and everything should be valued.

EL Does that mean if board members are contributing... potentially going out and courting people to be part of the board just for their dollar value?

DK Absolutely. If that fits in the context of everything else we've said. So, for me, how do you go out and get someone to join the board? What's the mission of the organisation is your start point. What are our values? That helps you to start to work out where to look.

Then you say, well, what's our current situation? What's our financial position, what's our strategic position, and what are we trying to achieve, what do we need?

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If you understand those things, you'll have a much clearer idea of what and who you need.

Then you've got to look at the total mix of the board. So, you might already have people who help you with the funding. So, maybe you don't need that, maybe you need something else.

If you decide you need someone who has funding and they can bring it themselves, then absolutely, go out and target that person. Why not? There are plenty of boards where people have been recruited on that basis, because they can make that contribution.

I would only say that the context is the important thing. And I'm not saying go out and recruit a whole bunch of people who can give you money, because then you'll have a whole bunch of people who can give you money, but you may not have the necessary skills, attitudes, perspectives or commitment to work.

EL David Knowles, from Koda Capital. In the next episode, the last one for the series, the focus is engagement. Phil Butler will be on the podcast again, as will Patricia Carroll, the CEO of St George and Sutherland Community College.

PC I believe that engagement means that they... they're fully present, they're fully passionate and they're fully involved.

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EL That's the next episode on the CCA podcast series on governance. You can find the full list of episodes at cca.edu.au.

This series is produced for Community Colleges Australia, by Heaps Good Media. Engineered by Miles Martignoni, and produced and presented by me, Ellen Leabeater. The podcast has been created with funding from the New South Wales Department of Industry.

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