

Proposal related to THE NPO Board Governance
For THE NPO Chairperson by Errol Goetsch
08 April 2004

1. Introduction

Following the ongoing discussions regarding Corporate Governance at the previous THE NPO board meeting, THE NPO Chair requested Errol Goetsch to produce a proposal for discussion at the Board meeting of 21 April. The range of the proposals would include THE NPO membership, board composition and nomination, director roles, etc.

Three meetings followed between GC, CDT and EG on the 4th March, the 23rd March and the 10th April. The hope emerged that this process, and the instruments that follow, could be re-used to assist other s.21 companies (and more) which face the same issues of corporate governance. The inputs from GC and CDT revised the first draft, and have been consolidated into the following:

- 1.1 The principles of board composition from two key sources
- 1.2 The gaps in the current articles and where they can be addressed
- 1.3 The recommendations for THE NPO's Articles of Association
- 1.4 The recommendations for a proposed Charter for THE NPO's Board
- 1.5 An annexure showing how THE NPO's purposes, as stated in the Articles, are expressed in its four programmes.
- 1.6 An annexure showing how members are currently categorised in the Articles.
- 1.7 A conclusion summarising the next steps

2. The Principles of Board Composition

Two documents are the key sources in South Africa of the principles governing board performance, and hence board composition and roles – the Companies Act and King 2. Each source contributes three principles. Between them, the legal and moral obligations for performance of the Board and each director have been dramatically stiffened.

2.1 The relationship between the two sources

The Companies Act in South Africa has its origins in the Companies Act in England, which in the 1840's laid down governance principles for companies issuing shares. The Companies Act is therefore the classical source for understanding the role of the board, the rules of operation and the penalties for breach. Its three duties - of care, skill and diligence - are legally binding

and breaches are crimes in the civil court. Amendments to the Companies Act and a stronger resolve from the JSE and Registrar of Companies, in part responding to strings of failures in South African corporate governance, have stiffened the penalties and made directors more personally liable for harms suffered by stakeholders.

The King Commission echoed in South Africa the Cadbury Commission in the UK, and recognised that the classical principles needed (1) further codification to protect shareholders (2) amplification to recognise new stakeholders, some external to the company and (3) to harness Information Technology to improve reporting and decision-making. King's recommendations were deliberately aspirational and voluntary, and have moral but not legal force.

King's three duties of transparency, disclosure and accountability are already implicit in the Companies Act, and do not add to director's obligations. However, to recognise that old and new stakeholders have uneven ability to understand the business and therefore manage their interests, they extend the classical duties to lift the minimum standards of conduct and reporting.

2.2 The Companies Act

The Companies Act imposes, amongst others, legal obligations on THE NPO's directors, summarised as the three duties of care, skill and diligence. Non-compliance gives 3rd parties the right to sue THE NPO's directors collectively for breach by any one director, and gives THE NPO's board the right to prosecute any director personally for their own breach.

2.2.1 Duty of Care (i.e. directors' must act in the best interests of THE NPO)

This obliges the Board collectively to represent members' interests. The emphasis is entirely on expressing member interests and not replicating member profile, so proportionality of race, gender etc. is (a) secondary to the legal obligation of performance and (b) no substitute for that performance.

The implications are:

- Membership must be categorised in the articles
- The interests of members need to be defined, and reflected in some document of authority (e.g. as the main purposes in the Articles of Association)
- The nomination process must reflect membership to some material degree, and the process and nominating board must be clear.
- The position of provincial networks and structures must be clarified

- Directors must endorse and apply THE NPO code and values
- The Board serves the objectives of THE NPO over and above the personal interests of each director, which means directors account to the board for conflicts of interest and non or under-performance.

2.2.2 **Duty of Skill** (i.e. directors must be able to govern all functions of THE NPO)

This obliges each director to add value, and collectively answer the need of the Board to ensure the company (1) achieves the purposes laid out in the Articles of Association and (2) is sustainable.

The implications are:

- Directors need to be possess technical merit over and above their profile
- Each director needs to possess a unique skill so that the portfolio of Directors has a complete skill-set without overlaps and underlaps
- There must be reciprocity on the Board for THE NPO's core functions "on the ground" i.e. a director for Finance, another for HR, and Marketing, and each of the programmes that make up Operations.
- An impact assessment (including risks) needs to be attached when the Board chooses between options so directors can assess their personal exposure.
- Each director must be sure that all board decisions were vetted and are right
- Each director needs to be inducted into and developed in their board role
- As an NGO, THE NPO will be more interrogated by its auditors for its sustainability than corporate "going concerns".
- There needs to be "refreshing" of the Board to maintain skills and energy, and therefore succession planning, role rotation, and caps on the length and number of terms.
- The size of the Board must not be restrictive and external expertise outside the membership must be included if needed.

2.2.3 **Duty of Diligence** (i.e. directors must attend meetings, prepare thoroughly and call for info missing, and exercise their skills continuously)

This obliges the directors to do the work of the Board, thus each director needs to apply their energy at and between board meetings.

The implications are:

- Director performance must be defined, measured and monitored
- The different roles on the Board (the Chair, Exco, other committees and the Executive Director), their rights and responsibilities, and accountability, need to be defined. (This would give each role a "job description").

- The individual Directors on the Board need to know what is expected of them, and the sanctions for non-performance. (This would give each director a “performance contract”).
- The directors need also to know the frequency, purpose, expectation and procedure of the various Meetings of the Board. (This would give each meeting a “job description”, each committee a “performance contract” and an “operational plan” to the sequence of meetings in a year).

2.3 King 2

King 2 offers principles that boards should aspire to, though without specific penalties in law for the board collectively, or any director personally, for non-compliance. Breach however risks the reputation of the board and the director(s).

2.3.1 Duty of Transparency

The duty of transparency vests in the Board of Directors as the principal instrument of corporate governance. The Board has a right of transparency with regard to the organisation, and a duty of transparency with regard to stakeholders. As the precondition for transparency, the Chair has to ensure that responsibilities are clear and both reporting systems and processes exist.

2.3.2 Duty of Disclosure

The duty of disclosure applies upwards, from staff member to manager, from manager to CEO, and from CEO to Board, and Board to stakeholder. The duty to disclose is in turn a right to a report. That report may be overlong as well as too short, so the information available to each director must be right in length, content, and time (during and between board meetings).

2.3.3 Duty of Accountability

The Chair accounts to members (and the law) for its performance

The Board accounts to the Chair (ditto)

The Executive Director accounts to the Board (ditto)

Managers account to the Executive Director (ditto)

Staff account to Managers (ditto)

3. A list of gaps in the current articles that can be addressed

The issues listed below are important to THE NPO without being fully addressed in THE NPO’s Articles of Association. This can be repaired by amending the Articles, or drafting a Charter for the board.

3.1 The relationship between the Articles and the Charter

The Articles are any company's most formal, most binding, and most rigid, rules in law, and are equal to THE NPO's "Constitution". For this reason, there are higher barriers to revision and unavoidable legal costs. External 3rd parties, including the Registrar of Companies, can prosecute and even wind the company down for breaching its Articles.

The Charter is binding, but is internally enforced only i.e. applied by the Board only and not 3rd parties. The Charter can be seen as the company's "legislation" – binding whilst in force, but with lower voting requirements for ongoing revision as conditions change, and no involuntary legal costs.

	Articles	Charter
1. Membership categories, representation and voting rights	X	
2. The size and mix of the Board	X	
3. The term of the Directors	X	
4. The grounds for eligibility as a Director	X	
5. The nomination procedures	X	
6. The values of the Board, expressed in a Code of Conduct or Board Charter	X	
7. The balance between the demands placed on directors and any reward	X	
8. The process of " job training ": induction and further development		X
9. Succession planning		X
10. Rotation of responsibilities		X
11. The director's individual roles that collectively constitute the Board		X
12. The frequency, quantity and type of information needed by the Board		X
13. The skills necessary for Boards to can make all its decisions with confidence		X
14. The level of performance that can be expected of directors		X
15. The measures of and mechanisms to improve care, skill and diligence		X

	<p>The set of members' interests being served</p>	<p>2. Government Departments Yes Yes ?</p> <p>3. Individual Grantmakers Yes Yes ?</p> <p>4. Interested persons Yes No or Yes? ?</p>																																																																								
<p>Decision 4</p> <p><u>THE NPO should amend the Articles to specify the set of members interests</u></p> <p>The interests common to members that need to be served (to reflect the duty of care requirement) can be lifted from the current purposes of THE NPO as reflected in THE NPO's four programmes and five services. The outputs of those programmes (see annexure) are specific and measurable, and can be recognised in the Articles.</p>	<p>Decision 5</p> <p><u>THE NPO should amend the Articles to reflect the skills and profile aspirations of the Board (though fine detail should be held back for the Charter)</u></p> <p>The following Skill-Profile Matrix may be used when composing the Board</p>	<table border="1"> <thead> <tr> <th rowspan="2"></th> <th colspan="3">Race</th> <th colspan="3">Gender</th> <th colspan="6">Geography</th> <th colspan="2">Member Type</th> <th rowspan="2">Total</th> </tr> <tr> <th>A</th> <th>B</th> <th>C</th> <th>W</th> <th>F</th> <th>M</th> <th>E</th> <th>F</th> <th>G</th> <th>K</th> <th>L</th> <th>M</th> <th>NC</th> <th>NW</th> <th>WC</th> <th>GM</th> <th>GD</th> <th>AM</th> </tr> </thead> <tbody> <tr> <td>Finance (including Risk, Sustainability)</td> <td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td>1+</td> </tr> <tr> <td>HR (including Risk, labour law, productivity)</td> <td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td>1+</td> </tr> </tbody> </table>		Race			Gender			Geography						Member Type		Total	A	B	C	W	F	M	E	F	G	K	L	M	NC	NW	WC	GM	GD	AM	Finance (including Risk, Sustainability)																		1+	HR (including Risk, labour law, productivity)																		1+
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<p>2. The size and mix of the Board.</p> <p>The board should be large enough to include</p> <p>a) Executives (because focused) and non-executives (because dispassionate)</p> <p>b) CEO (because senior) with other managers (as potential successors)</p>	<p>Policy and legislation (e.g. BEE Act) impose compliance requirements on the Board over and above the Companies Act and King 2. However, directors are personally liable for under-performance and first need to satisfy duties of care, skill and diligence. The following matrix assists the Boards to select individuals and balance the demands of function and</p>																																																																									

<p>c) Elders (because experienced) and juniors (because energetic) d) Skilled (because essential to make decisions) and the High Profile (because useful to promote decisions). The risks of political appointments are high: the person may fall from grace, not attend or deliver, be hard / impossible to remove, be upset by removal and 3rd parties may question the appointment or doubt the sincerity of the board.</p>	<p>profile. The matrix can be extended for age, public influence, executive and non-executive, and management. The matrix reflects: - Executives / Non-executives - The CEO / other managers - Elders / juniors - Skills / profile (w.r.t. demographics and influence) - The size range that accommodates these demands. Here the current 5 – 10 becomes at least 8, so possibly the new range is 8 – 12. - The balance between elected and nominated directors</p>	<p>design, reporting and training) Marketing (including income from membership growth, donor grants and product / service sales) Operations (including process and project management of (1) Training (2) Research (3) Advocacy (4) Information (5) Networking) Programmes (including (1) Enabling Environment (2) Corporate Governance (3) Institutional Development (4) Technical Innovation Programmes) Strategy (including environmental scanning, sustainability</p>	<p>1+</p> <p>1+</p> <p>3+</p> <p>1+</p>
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<p>a maximum of 3 terms of 1 year, but this not compulsory to avoid risking losing an asset. In addition, the maximum age is 70, but again not compulsory.</p>	<p>The cap on age Whether these caps are compulsory or not, and the grounds for exemption if THE NPO faces a material loss</p>	<p>Decision 9 <u>THE NPO should amend the Articles to reflect the maximum number of terms as:</u> 3</p> <p>Decision 10 <u>THE NPO should amend the Articles to allow exceptions where an asset may be lost</u> Let the term rules be obligatory, with exception possible only if some high % of members vote otherwise ? can you reword I am not clear</p> <p>Decision 11 <u>THE NPO should amend the Articles to make such rules equally applicable to all directors, whether executive or non-executive, elected or nominated etc who are non-executive directors?.</u></p>
<p>5. How to balance conflicts of interests</p>	<p>The rules for managing competing interests</p>	<p>Decision 12 <u>THE NPO should amend the Articles to reflect the 4 possible responses to conflicts of interest:</u> When directors are challenged with competing interests, they must declare them and the Board must choose whether the director(s) should:</p> <ul style="list-style-type: none"> a) Recuse (i.e. not participate and not vote) b) Participate without voting, c) Vote without participating, d) Participate and vote.
<p>6. The nomination procedures</p>	<p>The body responsible for nominations The rules for nomination The rules for eligibility and disqualification</p>	<p>Decision 13 <u>THE NPO should amend the Articles to reflect the nomination procedure:</u></p> <ul style="list-style-type: none"> a) The body responsible for nomination should be the nomination committee b) The committee should call for nominations and specify the criteria >4 months before the AGM c) The criteria should reflect the Board's portfolio of skills and profile needed

		<p>d) The committee should receive 3rd-party and self-nominations by 2 months before the AGM</p> <p>e) The nomination should be accepted by the nominee before nomination</p> <p>f) The nomination should state which skills and which profile criteria are satisfied</p> <p>g) The committee should vet the nominations for eligibility</p> <p>h) The committee should advise the AGM on skill and profile mis/matches</p> <p>i) The members should vote by proxy and in person at the AGM</p>
<p>7. The values of the Board</p>	<p>THE NPO should incorporate its Values and Code of Conduct</p>	<p>Decision 14 <u>The Articles should be amended to include</u></p> <p>a) THE NPO's 7-point Values (and directors must personally sign)</p> <p>b) THE NPO's 8-point Code of Conduct (and directors must personally sign)</p>
<p>8. The balance between the demands placed on directors and any reward</p>	<p>THE NPO needs to recognise that the absence of payment is no defence to the liability of directors. The Articles currently state that directors are not remunerated, unless performing some additional service for THE NPO, but this rule was laid down before the performance requirements and the legal risk to directors has increased</p>	<p>Decision 15 <u>The Articles must be amended to reflect the expectation of director performance in areas of</u></p> <p>a) Care</p> <p>b) Skill</p> <p>c) Diligence</p> <p>d) Transparency</p> <p>e) Disclosure</p> <p>f) Accountability</p> <p><i>(though the details themselves will only appear in the Board Charter)</i></p> <p>Decision 14 <u>The Articles must be amended to reflect the extent of exposure for Board or director's errors</u></p> <p>a) The Collective liability of the Board</p> <p>b) The Personal liability to the Board (for own and other error)</p>

	<p>dramatically under the Companies Act and King 2.</p>	<p>c) The limits of liability Decision 15 <u>The Articles must be amended to reflect the compensation for each director for</u></p> <table border="1" data-bbox="379 208 691 1420"> <thead> <tr> <th data-bbox="379 584 691 1319"></th> <th data-bbox="379 421 691 584">Financial</th> <th data-bbox="379 208 691 421">Non-Financial</th> </tr> </thead> <tbody> <tr> <td data-bbox="416 584 555 969">Specific performance <i>e.g. attendance</i> <i>e.g. service rendered</i></td> <td data-bbox="416 421 555 584"></td> <td data-bbox="416 208 555 421"></td> </tr> <tr> <td data-bbox="555 584 600 969">Attracting and retaining quality</td> <td data-bbox="555 421 600 584"></td> <td data-bbox="555 208 600 421"></td> </tr> <tr> <td data-bbox="600 584 644 969">Compensation for sacrifices made</td> <td data-bbox="600 421 644 584"></td> <td data-bbox="600 208 644 421"></td> </tr> <tr> <td data-bbox="644 584 691 969">Compensation for risks assumed</td> <td data-bbox="644 421 691 584"></td> <td data-bbox="644 208 691 421"></td> </tr> </tbody> </table>		Financial	Non-Financial	Specific performance <i>e.g. attendance</i> <i>e.g. service rendered</i>			Attracting and retaining quality			Compensation for sacrifices made			Compensation for risks assumed		
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5. Recommended inputs to a Board Charter after June board meeting

ISSUE	Principle	DETAIL
	<p>THE NPO add to Charter</p>	<p>THE NPO should consider the following decisions by Decision 16 a) Appoint party(ies) to draft a Charter that includes the agreed points from below b) Include in the Charter the process for future amendments of the Charter</p>
<p>9. The process of “job training”</p>	<p>THE NPO should draft an induction pack and process for incoming directors w.e.f. the next AGM</p>	<p>Decision 17 THE NPO should include in its board charter <u>The body, rules and process for drafting and maintaining an induction pack for incoming (or interested existing) Board members that covers</u> (1) What is going on (w.r.t. Finance, HR, Marketing, Operations and Programmes (2) Who the other board members are (3) Introduces the director to senior members of THE NPO</p>

		<p>(4) What the organisation does</p> <p>(5) What the statutory and other duties of directors are</p> <p>(6) What limitations on their powers exist</p> <p>(7) What are the roles of the Board, its members and committees</p> <p>(8) What performance is expected from each director</p> <p>Decision 18</p> <p>THE NPO should include in its board charter <u>The development process that</u></p> <p>(1) Assesses the director’s skills levels and repairs gaps</p> <p>(2) Assesses the director’s ability to exercise diligence, and promotes a minimum standard</p> <p>(3) Assesses the director’s ability to represent member interests, and promotes a minimum standard</p>
<p>10. Succession planning</p>		<p>Decision 19</p> <p>THE NPO should include in its board charter The body, the rules and the process for succession and grooming the next generation</p>
<p>11. Rotation of responsibilities</p>		<p>Decision 20</p> <p>THE NPO should include in its board charter</p> <p>(1) The need to plan for rotation and broaden the skills base</p> <p>(2) The rules for rotation (frequency, extent, and method)</p>
<p>12. The director’s individual roles that collectively constitute the Board</p>		<p>Decision 21</p> <p>THE NPO should include in its board charter</p> <p>(1) A list of a job descriptions for the (expanded) roles on the board</p> <p>(2) The number of representatives for a role (e.g. 2 vice-chairs)</p> <p>(3) The roles and responsibilities should be expressed as a clear “job description” for the chair, the CEO, the composition of the board, the reporting requirements, the allocation of</p>

<p>13. The frequency, quantity and type of information needed by the Board.</p>		<p>responsibility within the board, and jurisdiction</p> <p>Decision 22 THE NPO should include in its board charter</p> <ol style="list-style-type: none"> (1) The type (2) The quantity (3) The quality and (4) The speed of info needed by each role <ul style="list-style-type: none"> • Disclosure, reporting and communication: • What information is needed by the Chair, the board and stakeholders and are they getting the right quantity (i.e. the minimum that reveals the maximum) and quality? • Are the key business drivers / performance indicators known and reflected? <p>Is the important information distributed in-between meetings?</p>
<p>14. The skills necessary for the Board to can make all its decisions with confidence.</p>	<p>Boards need a skills audit to ensure they know what gaps exist in their individual and collective expertise esp. with regard to financial statements / organisational health. Amongst the board, these skills are needed to reciprocate operational challenges and for specialist oversight of THE NPO's</p>	<p>Decision 22 THE NPO should include in its board charter</p> <p>The body, rules and process for initiating and maintaining a audit of the skills available to the board to identify and repair gaps and to allocate roles</p>

	<p>functions:</p> <ul style="list-style-type: none"> • Finance (including accounts, auditing and sustainability) • HR (including labour productivity and law) • Marketing (including donor, member and service sales) • Operations (i.e. each of THE NPO's four programmes) 	
<p>15. The level of performance that can be expected of directors, including</p>		<p>Decision 23 THE NPO should include in its board charter</p> <ul style="list-style-type: none"> • Rules for confidential information • Rules for penalty for non-attendance • Rules to assure preparation for meetings • THE NPO should maintain a board attendance register and include statistics in annual report • Confidential information (e.g. conduct outside the boardroom dealing with information acquired inside the boardroom)

		<ul style="list-style-type: none"> • Promotion of THE NPO’s interests inside and outside board meetings. • Non-attendance: “3-strikes, you’re out” rule that disqualifies directors after 3 misses, regardless of apology. • The keeping of a board attendance register and its disclosure in the annual report.
<p>16. The measures of care, skill and diligence and the mechanisms to improve performance</p>		<p>Decision 23 THE NPO should include in its board charter</p> <ul style="list-style-type: none"> • Which body sets and applies the measures of board and director performance • What rewards and sanctions follow from over- and under-performance

7. Annexure showing the CURRENT definitions and member categories as expressed in THE NPO's Articles of Association.
Definitions used in Articles

	Definition	Comment
Grantmaking Organisation	CSI Departments within the business sector, or private foundations or trusts	Does not reflect <ul style="list-style-type: none"> • Government depts • Individual giving
Grantmaking Practitioners	Officers administering funds in grantmaking organisations	Does not reflect <ul style="list-style-type: none"> • Management consultants • Professionals (Lawyers and Accountants) serving in field • NGO's that practice the RECEIVING of grants
Directors	Directors duly elected at the AGM in terms of these articles. Trustees	"Trustees" dangles at the end of the sentence in the Articles and is not explained.

Membership Categories used in Articles

	Membership Categories	Qualification and Privilege
A	Independent SA grantmaking organisations	Unlimited number, equal vote, no more than 1 representative
B	Independent Foreign grantmaking organisations	Unlimited number, equal vote, no more than 1 representative
C	Independent grantmaking organisations that disburse government funds	Unlimited number, equal vote, no more than 1 representative
D	Individual members	Unlimited number, no vote
E	Associate members (SA and foreign statutory grantmaking bodies only)	No vote or special representation

8. Conclusion

What	Who	By When
Developing Proposal for board	Errol in consultation with Gail and Colleen	Completed
Circulating Proposal to board for comment	Gail and Colleen	Completed
Commenting on Proposal	Members attending meeting Members not attending meeting	
Incorporating Board decisions in Articles	As nominated by Board	
Commission amendments to articles (together with specific activities required)	As nominated by Board	
Commission development of charter (together with specific activities required e.g. skills audit, induction pack etc)	As nominated by Board	
Nomination process before AGM	Nomination Committee	
Submitting Articles draft at next board meeting	As nominated by Board	
Submitting Charter draft at next board meeting	As nominated by Board	
Circulating to members for decision at AGM	As nominated by Board	