MEASURING ORGANISATIONAL GOVERNANCE©
Through Transparency to Trust in Governance of Nonprofit Organisations

by

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"Can Public Trust in Nonprofits and Governments be restored?"

That the eye-catching rhetorical question was the title of a *Harvard Business Review* paper[i] in 1996 which argued that public trust depends on external accountability for performance in economic terms. Leaving aside the question of whether Nonprofit organisations are in disrepute in other OECD countries, the more universal question raised by that question is: how do external observers evaluate the performance of a Board of Directors of a Nonprofit organisation, or Government agency? This also begs the fundamental question: How do Boards of Directors evaluate their own and their organisation's performance?

Box 1
What are the basic steps in Evaluation?
In any attempt to develop an evaluative framework there are at least four commonly recognised steps[ii], such as:
1) Establish the evaluative criteria which are used to determine merit or worth of the object of the evaluation (evaluand);
2) Develop the knowledge base and instruments and/or standards to be used to measure against these criteria;
3) Conduct the assessment (or evaluation) against those standards or criteria;
4) Synthesise and interpret the data so as to form the judgement of the merit or worth of the evaluand.

Before Boards of Directors can validly account for the measurement of organisational governance, it would be wise to address the 4 basic steps in any evaluation process (see Box 1).

One evaluative criterion, which should be considered in any credible reply to the questions of trust in organisation performance, is the *appropriateness* of the corporate governance of the Nonprofit or public sector organisation. Like justice, organisational governance has not only to *be appropriate*, but also has to *be seen to be appropriate*, ie the evaluation of appropriateness should be *transparent*. Any attempt to evaluate appropriateness would require performance measurement which not only serves organisational governance and delivery of client outcomes, but also external scrutiny or transparency of governance.

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TRANSPARENCY

Public distrust may stem from the public likelihood that the citizens may perceive the degree of risk in public enterprises differently from the organisation, or Government, that is managing the calculated risk. Well before September 11th 2001, research[iii] conducted in the USA chemicals industries and environmental protection agencies has suggested that "*outrage*" factors are as important to the general public's perception of risk as the real *hazard* factors. Fear and outrage about the impact of risks, or failures to manage risk, are important factors in the need for transparency as well as due diligence in the 21st century governance. These researchers have shown that there is a disparity between what a non-technical audience has the greatest fears about, versus the truly most dangerous aspect of a risk. Thus there is a need for transparency of governance, especially early warning and education about risks and risk management.

EVALUATING APPROPRIATENESS

In the evaluation of organisational governance, the concept of appropriateness can be defined[iv]: as primarily an indication of the consistency or relevance of program objectives to organisational stakeholders' needs, in the legal, ethical, cultural and economic circumstances.

"The *public*" is not one homogeneous group, but consists of many and varied stakeholders. The experts [v]on risk communication suggest that stakeholders should at least be considered in terms of three concentric circles of interest, or potential audiences of risk communications, as:

- The *inner circle* – i.e., those most likely to be very interested (fearful of risks?), such as the clients, client interface staff and stakeholders represented by the Board of Directors, e.g. the Minister. They must be contacted and involved to the greatest extent possible.
- The *middle circle* – i.e., those who have less interest (or their concerns are more peripheral), but are apt to be fearful or outraged if not warned of risks; such as the other Government or nonprofit organisations in the same industry. They should be contacted, invited to be involved, and kept informed.
- The *outer circle* – i.e., those who are less likely to be concerned (little likely interest in risk; but may be fearful, outraged, or concerned if caught unaware of problems, or if the press/broadcast media get hold of "leaked" information). This often includes the "general public" and the press/broadcast media. Less effort is usually directed to these audiences than the other two; but there is a potentially strategic important risk if their ignorance leads to outrage, and backlash.

In this analysis it is assumed that organisational performance measurement system's appropriateness depends on its focus on the *interests* as well as *outcomes* for the clients and other stakeholders. Similarly, *transparency* of the accountability of the Boards of Directors for organisational governance is assumed to be a function of the representation and participation of the various stakeholders in the organisation's outcomes and the degree of disclosure of the Board's commitment to compliance with the various relevant laws.

Box 2
Defining Organisational Governance

The term *organisational* governance is used here to differentiate from the term *governance* more generally, and specifically from *corporate* governance. Corporate Governance has become associated with the management and control of organisations especially in the private sector under the corporation's laws of the country.

> *Governance* is often used in the public sector context to mean the Government's legal and political representation and leadership of the polity (the *people* or the citizens). For clarity, this might be better termed *polity governance* to distinguish it from the machinery of Government, which includes the *organisational* governance of the public administration.

CHANGES IN CORPORATIONS LAW

In Australia (as internationally) a sea change has occurred in the standards, principles, and laws pertaining to corporate governance affecting all organisations through the introduction of the Australian Standard on Compliance (AS 3806 -1998) and the changes to corporate law (Corporate Law Economic Reform Program or *CLERP*, 1997, 1999). These reforms of Corporations Law are emerging as applicable to the public sector[vi] and Nonprofit or third sector, as they are to the private sector. Two of the important changes are the specification of the duties of Directors, which include evaluation of the performance of the CEO, the organisation as well as the Board's own performance and the *Business Judgement Rule* which indicates the importance of *competence* of the decision-makers as well as competence of the agents, as a basis for safe haven from legal liability.

In Australia, under the CLERP changes in corporation's laws, there are clear duties of Boards of Directors to be *accountable for the performance* of their organisation, which include the need to:

* monitor the performance of the organisation (in relation to the needs of stakeholders/shareholders, and approve the *values* and the strategic plans of the organisation);
* appoint, and evaluate the competence and performance of, the CEO;
* ensure that the organisation has the capacity to achieve its objectives and that the staff, to whom they delegate the management of the organisation, are competent to do so;
* evaluate the performance of their functions as a Board.

In other words, through its role as the oversight of the values and ethics of the organisation, the Board of Directors has a strategic function in establishing the performance evaluation framework for the organisation, and of the Board itself.

Although there are variations on the roles and duties of Boards of Directors it is a common premise of corporate governance research and practice that the Board has the primary intent of continuously monitoring and influencing the organisation's performance. However, there is little research or evidence that in fact the competence in, and pursuit of, evaluation of performance by Boards of Directors does really influence the performance of the organisation. Similarly, there is little research or evidence about what criteria Boards of Directors *actually* use to evaluate the organisation's performance or the Board's own performance despite the burgeoning advice and consulting industry about what Boards should be doing. Similarly, in Australia, the few surveys of nonprofit organisations inquiring about their corporate governance have indicated the paucity[vii] of understanding of corporate governance and use of measurement of financial and non-financial performance.
Elsewhere it has been argued that Boards of Directors need to recognise and apply the competencies of performance evaluation[viii], especially in view of the CLERP Business Judgement Rule (2000). To facilitate appropriateness and evaluation of organisational governance in the nonprofit organisations, there is a need for an evaluation framework which

focuses on basic elements of performance information. Four models which might facilitate attempts to find common performance elements which can link strategy, control and performance with the field of organisational governance in the nonprofit sector.

None of them has all the answers for Boards of Directors facing their evaluation role in the performance orientation of corporate governance. However each has a role to add value to the theory and practice of organisational governance. They can provide the *knowledge* component of the evaluative criteria.

ORGANISATIONAL GOVERNANCE: AN INTEGRATED FRAMEWORK

The Australian Centre for Organisational Governance has developed *Organisational Governance: Integrated Framework*[ix]. This approach originated from the Institute of Internal Auditors of Australia's exposure draft titled the *Australian Control Criteria* which was released for comment in March 1998. Feedback, both nationally and internationally, supported the need for a more strategic systems view of organisational governance and profession neutrality as well as stewardship. This Framework encourages professionalisation of *stewardship* by the Boards of Directors for the stakeholders' interests and the development of the values base of the organisation in response to stakeholders' needs. In doing so it strongly advocates transparency of performance measurement so that directors and stakeholders may participate and contribute to defining effective governance and linkages to effectiveness, failure avoidance and due diligence.

BALANCED SCORECARD

As Kaplan and Norton[x] have pointed out, practitioners of business planning and performance measurement have traditionally neglected the strategically important linkages between financial and non-financial information, to the detriment of their organisational effectiveness. What Kaplan and Norton have attempted to provide through their '*balanced* score card' is a summary of the whole of the organisation's accountability in a single glance. Indeed, they are right in recognising the potential for information overload by Boards of Directors and CEOs, who may need a condensed consistent reporting format to be able to account for their performance monitoring and evaluation duties. But Boards of Directors, Internal Auditors, Managers and evaluation advisors run the risk of goal displacement if they do not follow a balanced approach to gathering performance information which maintains a strategic focus, rather than emphasising convenience and conciseness.

Despite the promise of the *Balanced Scorecard*, there are problems in its application to nonprofit organisations in Australia. Especially relevant here is the issue of how to apply their system to evaluation of the CEOs and the Board's performance. There apparently have been relatively few attempts to apply this approach to develop key performance indicators for Boards of Directors. Unfortunately, there is a tendency to the same types of problems encountered with performance indicators approach to program evaluation in the public sector. For example, the risk is that there will be goal displacement if the nonprofit organisations rely on convenience measures which focus on *inputs, processes and outputs*, rather than on the more strategic performance in terms of the *stakeholders' needs and outcomes* for customers or clients.

The *Australian Control Criteria* and the *Balanced Scorecard* models emphasise the need to improve accountability mechanisms for Boards of Directors to be able to develop effective

corporate governance. However, neither is particularly developed as a basis for actual performance measurement and data collection, especially in terms of client outcomes (except the *Balanced Scorecard* suggests that there should be a measure of how "we appear to our customers"). For example it is unclear how this model measures and accounts for the client outcomes (other than perhaps the gross measure of customer satisfaction). So how would the Board of Directors of a nonprofit organisation use this approach to report to external stakeholders in terms of client outcomes?
They both need to be complemented by more sophisticated forms of data collection to facilitate appropriateness and transparency.

Perhaps the triple bottom-line or *NAGASAT* models, which focus on performance measurement for evaluation and accountability, may be useful in tandem with the *Australian Control Criteria* or the *Balanced Scorecard*.

TRIPLE BOTTOM LINE

Kaplan and Norton are not the only management accounting theorists and practitioners to realise the limitations of the traditional financial *bottom line*. Sustainability became a United Nations focal point in 1981, and from the late 1980s other accountants and management theorists have been moved by the growing global concerns for sustainability. A watershed was the Brundtland Report in 1987 titled: *Our Common Future,* which has become a central part of the language of government and business world-wide. This put sustainability and environmental equity issues as well as quality of social and environmental aspects of business, into the spotlight so that professionals in all areas of organisational governance could not avoid it.

The most notable example of the movement to sustainability is the establishment of the so-called “triple bottom line”, viz accountability for an organisation’s financial, social and environmental performance[xi]. Indeed, the Institute of Chartered Accountants in Australia took up this theme with the formation of the Triple Bottom Line Issues Group[xii].

While a concerted effort is mounting among various professional groups, there is still much to be done to establish this approach and to prove these measures as valid and useful. For example it is unclear how such broad issues as "social accountability" might be measured and so how would it account for the client outcomes, which are quite often inadequately specified anyway? and so how would the Board of Directors use this approach to report to external stakeholders in those terms?

NAGASAT STRATEGIC EVALUATION MODEL

The underlying basis of the *strategic evaluation of organisational governance* is that there be a minimal performance measurement system, referred to as the *NAGASAT* model of performance measurement for evaluation[xiii]. This is used to integrate program evaluation and personnel evaluation to accommodate the role of the Boards of Directors in evaluation of the CEO's performance, as well as the organisation as a whole.

In order to address the fundamental strategic performance information needed to be able to appropriately monitor the performance of the Nonprofit organisation and its management has been advised to set up a framework for evaluation of effectiveness and appropriateness of the

organisation or its programs (Sharp, 1998a, b). For example a simpler approach has been tried by public sector and third sector human services organisations for example, the Australian Youth Foundation (AYF & Sharp, 1996) and the Multi-Purpose Services for health and aged care in rural and remote areas (Andrews, Dunn, Hagger, Sharp, & Witham, 1995).

These and other evaluation consultancies all have used a simple effectiveness oriented performance measurement model called *NAGASAT* (Sharp, 1998a,b) where the following performance information was regarded as essential for accountability and to complement the financial aspects of accountability:

- *Needs Assessment*
- *Goals Attainment and Client Outcomes*-focused performance information (e.g., Goal Attainment Scaling)
- *Satisfactions Assessment* (e.g. customer satisfaction; staff satisfaction) and
- *Transfers* (e.g. succession planning for competence, skills development, knowledge, value-added).

To keep an appropriate strategic focus (while allowing transparency), all this information was summarised from the s*takeholders'* (i.e. including Directors, Managers, staff and those with a strategic interest in the organisation, as well as customers) points of view (as shown in Figure 1). Its main advantage is the close linkage to the client needs and outcomes. It thus meets one aspect of transparency in terms of one stakeholder group in the inner circle.

If a system of performance monitoring can not deliver regular and appropriate information on such basic factors as identified in the *NAGASAT* performance measurement model, then the Boards of Directors ought to be concerned about whether there is a system in place to be able to meet the criteria of transparency and appropriateness, as well as effectiveness of organisational governance. Of course this simple performance monitoring is only the minimal condition for *Strategic Evaluation* to be established – then Boards of Directors have to learn how to use it, and ensure that the results are valid and transparent for the context of the organisation and its stakeholders.

Figure 1 is an overview of the *NAGASAT* model of performance measurement for strategic evaluation. Basically the methodology links performance measurement to the basic accountability points for strategic plans. The needs of the stakeholders, the goals of the program, the processes and outcomes (Goal Attainment Scaling and assessing satisfaction of stakeholders about process and outcomes) and the degree of transfer of knowledge for learning and continuous improvement all have to be taken into account for strategic evaluation.

Indeed, the *NAGASAT* model of performance measurement for evaluation could complement the *Balanced Scorecard* and Australian Centre for Organisational Governance models, by providing a data collection and analysis in an evaluation of organisational governance. In other words, even if the Boards of Directors (or management) of the organisation want a *Balanced Scorecard* for reporting they still have to develop the actual measurement system to provide the data. The *NAGASAT* model actually suggests that any of the four aspects of the *Balanced Scorecard* could be better understood if there was useful information about the:

- Needs of the stakeholders (in the financial quadrant of the *Balanced Scorecard* this could mean long term financial security, or secure asset management)

- Goals and related performance indicators for the financial could include a target of a higher than industry average return on investment (measured by $% values of current account)
- Satisfaction of fundors could be measured by both the loyalty and their survey responses on a relevant questionnaire;
- Transferability could be the long-term "going concern" report by auditors and the financial account for intangibles such as good will and intellectual property rights.

An eclectic s*trategic evaluation* approach is needed to provide a mix of evaluation tools to complement the Board's roles in strategic management and performance evaluation. It addresses the transparency criterion by facilitating stakeholder participation around prioritising needs and strategic goals.

FIGURE 1:
NaGaSaT MODEL
OF THE COMPONENTS OF A STRATEGIC EVALUATION CYCLE

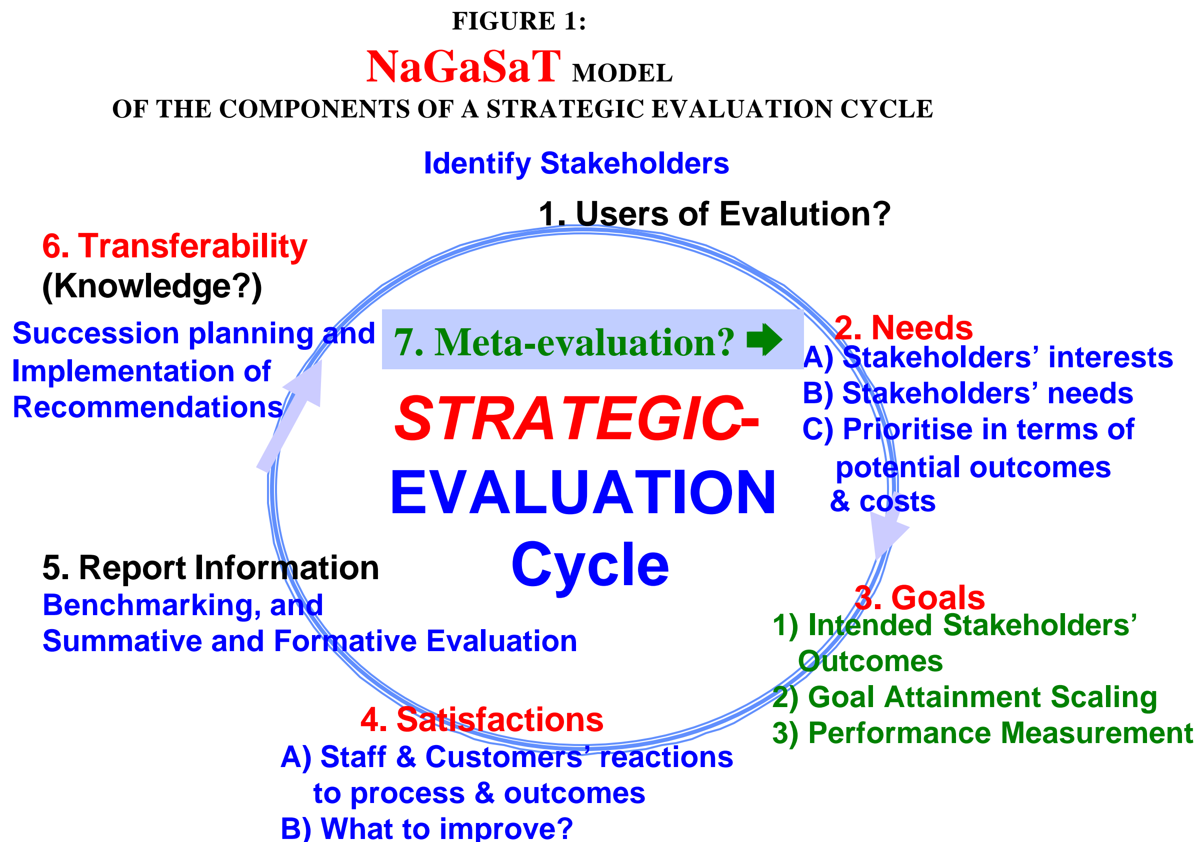

Figure 1 can only give a basic overview of the inter-relatedness of the needs, goals and satisfactions data, and the logic of integrating these data through transferability into organisational capability by Boards of Directors.

There remains the question of the availability of data to test validity of the performance measurement systems of organisational governance, such as the *NAGASAT* model and the ACOG's Framework. However, the present process of clarification of the models should make the task of further research on effective organisational governance more viable.

WHAT CAN NONPROFIT BOARDS DO ABOUT APPROPRIATENESS?

The four models briefly examined here tend to broaden the concept of corporate governance of nonprofit organisations to cover the role of Boards of Directors in making the accountability of the board transparent in terms of performance measurement and evaluation. *Transparency* is the foundation for understanding, and evaluation of, appropriateness of these models to organisational governance in nonprofit organisations. Boards owe varying degrees of evaluative information to three types of stakeholders to whom transparency may mean different outcomes, viz: the *inner, middle and outer circles.* One aspect of transparency identified, especially for the *inner circle,* is the direct measurement of needs and outcomes of clients of the organisation. However, there is still much to be done in the research on the appropriateness and transparency of effective organisational governance.

In the search for approaches which promote measures of *appropriateness* of organisational governance, *Stewardship*, as well as *strategic evaluation*[xiv] are recommended as professional competencies of Boards of Directors for nonprofit organisations to meet the requirements of the new Corporate Law Economic Reform Program's business judgement rule and the pressures of increasing risk of nonprofit agencies.

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i Herzlinger, R. E. 1996. “Can Public Trust in Nonprofits and Governments be restored?” *Harvard Business Review*, vol. 74, no. 2 (March –April), pp. 97 – 107.

ii Scriven, M. 1991. *Evaluation Thesaurus*, 4th ed., Newbury Park, Sage.

iii Sandman, P.M. 1993. *Responding to Community Outrage: Strategies for Effective Risk Communication*. American Industrial Hygiene Association, Fairfax, VA.

iv Sharp, C.A. 1994. "What is Appropriate Evaluation? Ethics and standards in evaluation" *Evaluation News & Comment,* vol. 3, no. 2 (December) pp. 34-41.

v (e.g., see Sandman, 1993)

vi McPhee, I. 2000. "New Responsibilities for Officers of Commonwealth Authorities and Companies". Speech Delivered 15/03/2000 National Institute for Governance, University of Canberra [online Australian National Audit Office http://www.anao.gov.au/Web/wsPub.nsf/SpeechesByPresenter/A2E473ECFF49DAFC4A2568FE0023EC09 accessed 1/9/01]
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vii McDonald, C. 1999. "Internal control and accountability in Nonprofit Human Service organisations" *Australian Journal of Public Administration*, vol 58 No 1pp. 11 - 22;
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viii Sharp, C.A. 1998. “*Strategic Evaluation* –Beyond the *Balanced Scorecard* for Corporate Governance”. Refereed conference paper: *Australia & New Zealand Academy of Management Conference*, Adelaide, 7th December, 1998.
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ix ACOG 2000a. *Defining Organisational Governance*. Adelaide: Australian Centre for Organisational Governance [online http://www.stewardship.on.net/Principles/OrgGov.html accessed 22/8/00]

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x Kaplan, R.S. and Norton, D.P. 1996. *The Balanced Scorecard.* Boston, Harvard Business School Press.

xi Elkington, J., 1997. *Cannibals with Forks: The Triple Bottom Line of 21st Century Business*, Capstone, Oxford.

xii Deegan, C. 1999. *Implementing Triple Bottom Line Performance and Reporting Mechanisms – further considerations.* Chairman, ICAA Triple Bottom Line Issues Group (formerly Environmental Accounting Task Force) Institute of Chartered Accountants in Australia. [online http://www.icaa.org.au/triple/tblconsiderations.doc accessed 6/1/2000]

xiii (see ACOG, 2000b; Sharp, 1998).