REIMAGINING GOVERNANCE

# BOARD ESSENTIALS

## Requirements and responsibilities of directors of nonprofit organizations based on the law and regulation

ONTARIO NONPROFIT NETWORK

Ignite NPS
Turning Insights into Action

# Important Note

Some of the content is based on what is written in legal and regulatory documents (e.g. Canada Not-for-Profit Corporations Act [CNCA]) and the Ontario Not-for-Profit Corporations Act [ONCA], while other content describes conventions that are widely accepted interpretations of them.

We are grateful to the following legal and governance experts who generously shared their ideas, experience and knowledge in the creation of this document:

Ruth Armstrong, Vision Management Services

Terrance Carter, Carters

Lynn Eakin, Ontario Nonprofit Network

Gordon Floyd

Linda Godel, Torkins Manes LLP

Susan Manwaring, Miller Thompson LLP

Lyn McDonell, The Accountability Group

Deryck Williams, CanadaHelps and (retired) Grant Thornton LLP

A special thanks to Susan Manwaring who reviewed this document for general accuracy.

Organizational leaders can use the information in this document as an educational tool prompting new and innovative possibilities for where and how they can share governance decision-making. Directors must always ensure they are fully informed about all legal and regulatory requirements related to their organization and have a deep knowledge about their responsibilities.

Important note: the information provided in this document does not offer legal advice and is not a replacement for legal counsel.

# Context

## Purpose

The purpose of *Board Essentials* is to clarify and prompt more innovation in the way that nonprofit organizations are governed. It describes the required composition of the board, and the responsibilities, duties and liabilities of directors of nonprofit organizations operating in Ontario based on the law and regulation.

This document, *Board Essentials,* is a complementary tool to the broader description of the functions of governance. ***Board Essentials* describes the requirements and responsibilities that must be fulfilled by the board of directors, and which no other person or entity can perform.** This core work of the board is based on what the law and regulations state are the requirements and responsibilities they must meet. While the board might play a significant role in fulfilling other governance functions, these are the essential ones.

*Board Essentials* aims to be as clear and concise as possible because descriptions of the board's roles and responsibilities can be vague, and sometimes misleading. For example, "oversight" has a wide range of meaning, from "directs and controls" to "supervises" to "a failure to notice something". How this language is interpreted by organizational leaders has a powerful, and often unintended, influence on relationships and power dynamics.

**Board Essentials creates greater clarity about what the board must do, so it's easier to determine what can then be delegated, shared or done by others.**

This clarity promotes a shared or distributed leadership approach, allowing the organization to draw a diversity of perspectives, skills and knowledge from a wider network or pool of people. It also enables organizations to fulfil functions based on who is best equipped to do them rather than the board feeling it must do them all.

## The Initiative

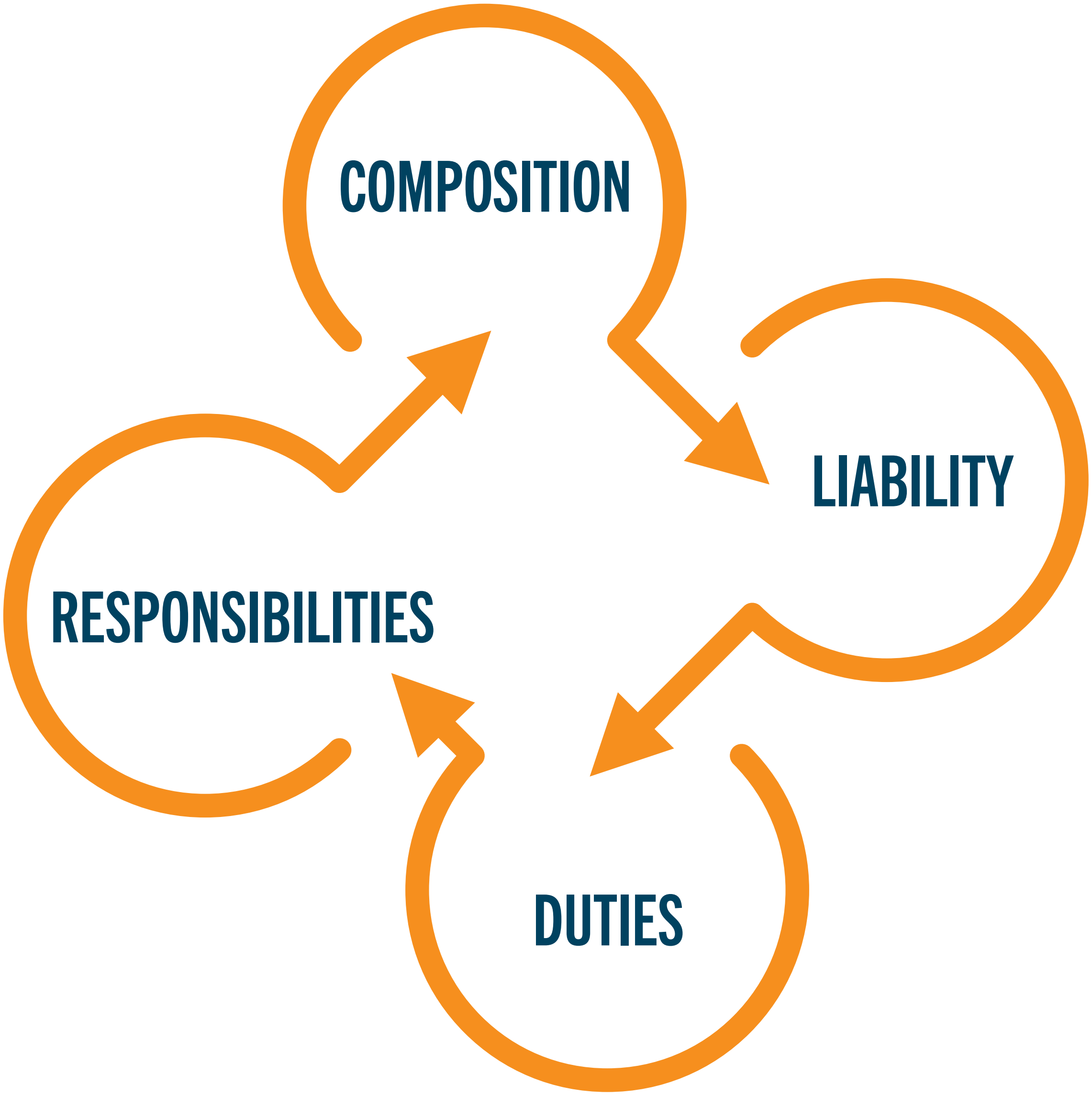
The goal of the **Reimagining Governance initiative** is to provoke a shift in how nonprofit organizations talk about and fulfill governance. Our research uncovered that the shift is necessary because the current design of governance in nonprofit organizations is **not consistently effective or always positioned to respond effectively to the increasingly complex environment of today and the future.**

A lot is being asked of a board of directors in these complex times, particularly given the growing and increasingly sophisticated demands placed on them. This is challenging for the many organizations that struggle to recruit board members with the competencies required to govern well. In response to this issue, the initiative has created a **Governance Framework** and tools that prompt a different way of looking at governance. For example, the Framework:

- Presents an organization's governance as a complex system with myriad influences shaping it and with many people that play a role.
- Describes the functions as only those related to the work of governance, not other operational activities, like fundraising, program development, stakeholder engagement and advocacy. These are important activities but aren't governance work.

# Board Requirements

There are four requirements that must be fulfilled by the board of directors:




**Articles of incorporation or letters patent** are the official documents that must be filed when an organization is created. The pending Ontario Not-for-Profit Corporation Act (ONCA) requires that organizations stipulate the range in number of directors, the classes of members the organization is authorized to establish and if there are two or more classes, the voting rights of each class.

**Bylaws** are created by the organization and describe the structure and internal procedures. The bylaws follow legislative requirements *(e.g. filling board vacancies, electing directors, quorum requirements),* but where permitted by the governing legislation, organizations have the discretion to change or adapt them to their own purposes.

# Composition

- Generally, there will be at least three directors in a nonprofit organization[1]. Private nonprofit organizations[2] *(e.g. a private foundation owned by one person)* may be established with only one director, although it is common to have more than one.
- ONCA and CNCA also restrict the number of directors that may be employees of the organization or of any of its affiliates.
- Directors must:

| | |
|---|---|
| √ be at least 18 years old; | √ be capable to act as a director, carrying out their duties and responsibilities; |
| √ not be bankrupt; | |
| √ be an individual; | √ be or meet any other criteria as set out in the organization's bylaws. |

# Liability

Generally, an organization is liable for claims against it or any breaches of its obligations that create damages to the organization. A key reason to incorporate is that the members and directors are insulated from personal claims, except in specific circumstances. Many claims brought against organizations never mention Directors.

Directors are likely covered for any claims against them by the organization's Directors and Officers Liability Insurance *(D&O)*, except where the D&O has identified specified exceptions or in the case of fraudulent, criminal or grossly negligent behaviour.

Directors can be held liable:

- Collectively *(as a whole board)* and individually *(as one director)* for an organization's failure to comply with certain specified legislative requirements, or for a breach of a requirement, if the directors do not take prudent steps to ensure that the organization meets these obligations.

  More specifically, directors can be held liable based on statutes that impose liability, such as under the Income Tax Act for failure by the organization to remit employee source deductions or collect HST, or for employee wages under the ONCA.

- Acting in a way that is outside the scope of their role as a director, but that has impact on the organization. For example, by making a defamatory statement that damages the organization.
- For breaching their Duties of Care and Loyalty *(but generally liability will only be to the corporation and to the members).*

[1] *Nonprofit organizations are defined as the full spectrum of non-share capital corporations, including incorporated non-profits and registered charities. While legal and regulatory documents refer to 'corporations', we've used the more common language of 'organizations'.*

[2] *These are closely held organizations or organizations that do not raise funds from arm's length parties.*

# Duties

The duties of directors are designed to safeguard the organization as well as individual directors. They are:

## Duty of Care:

**Directors don't have to make perfect decisions or be experts; however, each director must exercise the care, diligence and skill in their decision-making, and in fulfilling their responsibilities, that a reasonably prudent person would exercise in comparable circumstances** *(e.g. lawyers or accountants aren't judged against their specific expertise, but against what an average person sitting on the board would do).*

The following are **conventions** describing how the Duty of Care is performed by directors *(e.g. they are not stated in the law or regulation but are the most commonly expected behaviors of directors who are fulfilling their Duty of Care).* Directors must:

- **Demonstrate due diligence in the degree of care, attentiveness and vigilance given to their decisions.** For example, each director must:

  √ remain well informed;
  √ attend meetings regularly;
  √ review all background materials before the meeting;
  √ exercise their best judgement and apply critical thinking;
  √ and vote according to their own opinion, avoiding "group think".

  Keeping minutes is not only a legal requirement, it's an important way for directors to demonstrate due diligence. No person can act for an absent director at a meeting.

- **Have confidence**[3] **that the organization is complying** with all the applicable laws and regulations related to the organization as well as its governance documents.

If the organization is a charity, the directors may be held to a higher standard of care *(e.g. like that of a trustee of a charitable trust).* This is particularly the case when the directors are dealing with issues related to the protection of the assets or property of the charity. *(See responsibilities)*

## Duty of Loyalty:

**Directors must act honestly and in good faith in the best interests of the organization.**

The following describe the most common **conventions** about how the Duty of Loyalty are met:

- When making board decisions, a director **must put the organization's interests above their own and above another organization to which they have fiduciary duties** *(e.g. loyalty and care).* One of the important ways that directors abide by this duty, is to ensure there is a 'Conflict of Interest' policy in place, which is enforced.

**Note:** In a charitable organization, a director cannot profit from their position. Directors cannot receive directly any remuneration for services, although they can be compensated for direct expenses related to their work as a director. Also, directors may not indirectly benefit in cases where there is a significant benefit to the organization *(e.g. hire a board of director's law firm for reduced fee)*, unless certain circumstances are met. In a nonprofit organization, directors can receive reasonable payment for their services as a director, although it is not common, nor considered best practice in public benefit organizations.

*[3] There are many ways directors can 'have confidence', including knowing that the chief staff person has the competency to fulfill requirements, by receiving regular reports regarding compliance, and putting in place the mechanisms (e.g. policy) so compliance is properly done.*

# Responsibilities

Directors must fulfill, and will be held accountable, for the following responsibilities. They must:

## Be assured[4] that the organization is:

- **Carrying out the purpose** of the organization as set out in the articles of incorporation or letters patent. All the organization's activities, programs, strategic directions or other actions must be related to the purpose *(e.g. the organization must be able to show how they are tied to the purpose and furthering it)*.
- **Complying** with all the organization's legal, legislative and regulatory requirements.
- **Behaving in a financially responsible manner.** The conventional ways that boards do this is by being assured that:

**Note:** These will vary depending upon the purpose of the organization and its programs and services. For example, organizations like hospitals, universities, long-term care homes and children's aid societies have compliance requirements in addition to those that apply to other organizations.

| | |
|---|---|
| √ | operations are run prudently *(e.g. with care, common sense, and consideration of the future)* and in a manner that furthers and supports the organization's purpose<br>Note: Charities may be held to a higher standard of care[5] as they relate to the protection of the organization's assets and how they are utilized (e.g. money, real estate, equipment). For example, restricted donations must be used in accordance with donor's stated wishes. |
| √ | policies and practices are in place to mitigate risk, including human, financial and reputational |
| √ | material contractual obligations are met |
| √ | financial statements are approved and if an audit is required, it is well conducted. |

- **Managed properly.** In the case of organizations with staff, directors fulfill this responsibility by **hiring, evaluating the performance and terminating the chief staff person,** such as the CEO or Executive Director. For example, to effectively hire the chief staff person, directors develop and revise the job description. Directors evaluate the effectiveness of the chief staff person through formal and regular performance reviews, based on clear measures of success. The level of due diligence required will vary on a sliding scale *(e.g. the complexity of the evaluation that takes place);* large and/or sophisticated organizations require more due diligence than small and/or less complicated ones.

  If there are no staff, the directors probably perform the day-to-day activities of the organization. But directors in their governance role, are still responsible for holding themselves accountable for how well the organization is managed *(e.g. through regular evaluation processes)*.

*[4] A director cannot 'ensure', with absolute certainty that something is done. However, they are responsible for putting in place processes and policies (e.g. adequate internal controls, such as two people signing cheques over a certain amount of money) to give them confidence that the responsibility is met.*
*[5] At common law and under the applicable statutes*