

Excerpt from *Charities and Not-for-Profit Administration and Governance Handbook, 2nd Edition*, by Donald J. Bourgeois (LexisNexis Butterworths, 2009).

DIRECTORS AND THEIR ROLE IN MANAGING THE ORGANIZATION

A. INTRODUCTION

The directors are any organization's primary asset. This statement may seem to be inconsistent with other pronouncements on what is most important. For example, it is common for private sector, public sector and voluntary sector employers to state that their employees or volunteers are their greatest assets. Others argue that an organization's major asset is its reputation.¹ All of these statements and others are likely accurate in general and for specific organizations.

Directors are, however, unique. An organization is a legal artifice. It exists in law and as a legal concept for practical purposes. An organization allows people to structure their internal relationships and external dealings with others in an efficient and effective manner. Nobody can touch, feel, see or hear an organization; it has no physical reality. It becomes real through the actions of people. And directors are responsible for making sure that the organization relates to people in accordance with the law, that it acts in a fiscally prudent manner and that it is effective in achieving its purposes.

The organization itself may exist as a separate legal entity. Corporations, for example, are established by law as "legal persons". A large number of organizations, however, have no or little "legal personalty". These organizations are unincorporated associations which are not legally "persons". In some cases, the common law or statutory law does recognize a limited legal personalty to these unincorporated associations, for specific purposes. In other cases, the

¹ The importance of "reputation" and acting such that the reputation of the organization is maintained and enhanced is discussed in D.J. Bourgeois, *Charities and Not-for-Profit Fundraising Handbook*, 2d ed. (Markham: LexisNexis Canada Inc., 2006) at 6-10 and in chapter 6 of this text.

organizations may be “trusts”, in which the assets are held in trust by legal persons, such as individuals or corporations.

Regardless of the legal structure, it takes real people for an organization to act. The law — in the form of the courts, regulators and governments — and the public look to directors and officers as the primary method by which organizations act and for accountability purposes. The law and the public have developed expectations that directors and officers will ensure that the organization achieves its goals, complies with the law that applies to the organization and operates in a fiscally prudent and effective, efficient manner. The method for doing so is often called “governance”.

One of the challenges facing the federal and provincial levels of government and organizations themselves has been determining an appropriate governance structure that is responsive to the needs of the sector as well as the requirement of checks and balances. As the sector has matured and developed stronger professional leadership, tensions between the board of directors and staff have increasingly arisen. This tension may be either a “dynamic” one, which encourages full discussion of the issues and an appropriate decision-making process, or a destructive one that results in poor relationships and a potentially dysfunctional organization.

B APPROACHES TO GOVERNANCE

The legal, governmental and public expectations of organizations are articulated and summarized in a number of ways — but they always focus on the organization and how it is governed by its directors. The terms “governance” and “stewardship” are used in *Building on Strength:*

*Improving Governance and Accountability in Canada’s Voluntary Sector.*² This seminal report

² Panel on Accountability and Governance in the Voluntary Sector, Final Report, (Ottawa: February 1999). The Panel was an initiative of several sectoral organizations. It led to the Voluntary Sector Initiative in 2000, a joint endeavour between the sector and the Government

was the work of a panel of distinguished Canadians with experience and knowledge of the voluntary sector. The panel was established by several national organizations to provide guidance on governance and accountability. The report is seminal because it became the basis for ongoing work in modernizing the voluntary sector and its regulatory framework, and for making it more effective.

“Governance” for the panel is a combination of both the overall processes and the structures that are used in directing and managing the organization’s operations and activities.

“Stewardship” is the responsibility of the board of directors of an organization and involves the active oversight by the board of the organization’s governance. These two concepts are easily stated, but a great deal is packed into them — something that is readily apparent by the length and complexity of the panel’s report and background materials.

The need for such a panel grew out of several dynamics that were at play in Canada (and throughout the world) in the late 20th century and have continued into the 21st. Most of these dynamics were and remain beyond the control of the voluntary sector as a whole and certainly of individual organizations. The panel was struck in part to help the sector to respond to these dynamics and to provide guidance to organizations on how to do so. These dynamics include:

- changing role of government from a service deliverer and direct provider of services to a standard setter;

of Canada. The assessment of the success of the VSI has been mixed; while some movement has occurred in specific areas, such as interim penalties for registered charities, overall, the Government of Canada is not seen as having advanced adequately the agenda. See Kathy L. Brock, “Judging the VSI: Reflections on the Relationship Between the Federal Government and the Voluntary Sector,” (2004) 19:3 *Philanthropist* at 168-181 for an assessment of success (or lack thereof) of VSI. Nevertheless, the Panel’s work itself remains the touchstone on governance and stewardship in Canada.

- the downloading of what had been government activities and functions onto the voluntary sector and the private sector. The federal, provincial, territorial and municipal levels of government may each take their own approach, but “alternative service delivery” and “private/public partnerships” are clearly a trend that has continued into the 21st century regardless of the political stripe of a government;
- changing social and economic realities facing communities and groups within communities — not the least of which are the impact of the “new economy”, “globalization”, new international structures, and economic stresses;
- an increasingly diverse population and cultural backgrounds in Canada, which has intensified in the 10 years since the publication of the Panel’s report;
- a movement from philanthropy by the private sector towards “sponsorships” and marketing. Although there has been some recognition within the private sector of the problems that this approach creates, it has not resulted in any overall change to it;
- a reduction in overall support by governments of organizations and a refocusing of what remains from core-funding to project funding. This dynamic together with the movement away from philanthropy by the private sector appears to have led many organizations towards activities that will receive funding but which may or may not be consistent with the organization’s and its members sense of priorities. Governments have also identified the damage that the reduction in support and the project funding approach have caused, but have done little to alter either on a comprehensive and systemic basis;
- increased competition in the “charity” marketplace — be it for grants from governments or foundations, contracts for the delivery of services, donations and sponsorships from businesses, donations by individuals, or the operation of for-profit “business activities”. This

competition has led to a highly sophisticated fundraising industry within the voluntary sector in which larger and more established and recognized institutions (such as hospitals, universities and major health organizations) have a substantial edge over others in the sector. At times, the competition has also been deliberately against the private sector, which may have deeper pockets, different motivation, and more sophisticated management structures in place³;

- greater demands for accountability by governments, funders and the general public.

Accountability is defined not only in terms of proper use of funds but in the effectiveness and efficiency of the organization and in meeting the needs of the community; and

- more knowledgeable volunteers who have specific “wants” from their volunteer experiences.

There are two conceptual approaches to “governance” and “stewardship”. The more traditional approach is that the directors “manage” the affairs of the organization. The board would make most substantive decisions based on materials provided for board meetings and the discussion or debate at the meeting. The second approach is based on an “oversight” role for the directors to ensure that the organization is effective and is accountable. The oversight role relies more on the development of operational and other “policies” by the board of directors, which then looks to the officers and staff to implement.⁴ The two approaches are sometimes labelled the “administrative governance board” model and the “policy governance board” model.

³ See D. O’Connor, “The Dark Side of Contracting with Government: The Case of the VHA Hamilton and the Province of Ontario,” (2004) 19:3 *Philanthropist* at 201-210.

⁴ John Carver is a major proponent of this approach, which gained prominence with the publication of his *Boards that Make a Difference: A New Design for Leadership in Non-profit and Public Organizations* (San Francisco: Jossey-Bass Publications, 1991). Although not necessarily new conceptually, the text became an important opportunity for boards and organizations to re-examine how they operate and what structures were most appropriate for their circumstances. “Carverizing” an organization became a touchstone for some as a solution to many problems.

In reality, most organizations have operated and will continue to operate using a mixture of these two approaches. If the organization has staff, by-laws would, for example, often permit the executive director to manage staff in accordance with board-established human resource policies. Often, the by-laws or board resolutions determine the authority of the executive director to spend money within a budget set by the board. For larger organizations, these policies have typically included human resources, financial operations, advocacy, programming and so forth. Staff would be required to report to the board or a committee of the board on compliance with and deviation from the policies and on issues that arise for which greater direction is required.

There are both practical and legal limits to the extent to which boards may “delegate” their responsibilities through the issuance of policies. Boards will always have an “oversight” role in any organization but boards of corporations must be able to demonstrate that they “manage the affairs” of the corporation. Subsection 283(1) of the Ontario *Corporations Act*, for example, provides that the directors are to manage the affairs of the corporation.⁵

The proper mixture of “management” and “oversight” through policies is organization- and time-specific.⁶ There are practical limits to the abilities of directors to manage the affairs of large organizations with many employees. It is physically impossible for these directors to make all of the decisions that are required to be made on a day-to-day basis. Arguably, these directors could be negligent if they attempted to do so because decisions would not be made by the person most

⁵ R.S.O. 1990, c. C.38.

⁶ See also Professor Vic Murray, “Improving Performance,” (1996) 13:4 *Philanthropist* at 3-35, who comments that “There is no one best way to design and manage a nonprofit board” (at 3). He further notes that any model must fit the needs created by that organization’s history, culture, future plans, and the personalities of the key board and staff members and needs to fit the circumstances. The key element is ensuring all understand who is responsible for what and how evaluation is to be carried out. Prof. Murray reiterates this overall approach in *The Management of Non-Profit and Charitable Organizations in Canada*, (Markham: LexisNexis Canada Inc., 2006).

competent to do so, the decisions would not be made in a timely manner and the directors would be wasting the skills and talents of its employees. The same argument, however, could not be made for a small organization that has no employees and has no significant day-to-day activities. Although that organization may want policies in place to guide the board's decision-making, the board would continue to make most if not all decisions.

There is a spectrum between the two models of administrative governance and policy governance. Where on that spectrum an organization lays will depend upon a number of factors:

- the legal authority of the directors and officers and of the organization itself;
- statutory or common law obligations or restrictions;
- letters patent, by-laws, constitution or other constating documents;
- culture of organization;
- views and perspectives of key stakeholders;
- skills, competence and training of staff (assuming the organization has staff);
- size and type of operations and activities carried out by the organizations and their complexity; and
- due diligence requirements of the directors and of the officers.

There is no clear legal articulation of what is meant by “manage the affairs” of an organization. It will differ depending upon the issue, the circumstances and the organization. There are also certain decisions that are so fundamental to the affairs of any organization, that only the board should be making those decisions. For example, the budget of any organization ought to be approved by the directors and the board, or a committee of the board ought to be involved in the preparation of the budget for larger organizations. In other situations, the law may require that the board be involved other than through policy statements – either directly or

indirectly where the ramifications are such that no prudent director would consent not to be involved.

The panel on governance and accountability recognized that there is no “one size fits all” approach to governance and stewardship. It recommended “a good practice guide for effective stewardship” for large and medium-sized organizations, which is also intended to be a checklist for smaller organizations. The panel concluded that there were eight tasks that were key to effective stewardship by boards:

1. *Mission and Strategic Planning*, which involves the definition of the fundamental goals and strategy of the organization. It considered this task the most important duty for the board because it established the basis for accountability — the basis on which to determine the appropriateness of the board’s actions, performance of management and the success of the organization. The mission and strategic planning, though, must be consistent with the letters patent and by-laws of the organization (or as they are amended in accordance with the law), any external restrictions on the use of the organization’s assets, fiscal prudence and responsibility and any statutory, contractual or other legal obligations. Too often, organizations have developed very good mission statements and strategic plans — but ones that bear little if any relationship to what the organization can legally do.

For example, a church group incorporated for missionary purposes may not have the legal capacity to operate a summer camp, regardless of the usefulness of the summer camp.⁷ If the letters patent establishing the corporation do not extend to this type of operation, the organization would be acting *ultra vires* or outside its legal capacity and the directors and officers could be personally liable for any damages to the corporation. These damages could

⁷ See for description of this example *Volunteers & the Law: A Guide for Volunteers, Organizations and Boards* (Vancouver: The People’s Law School, 2000) at 54.

include losses on the operations or from closing down the operation once it was determined that it could not operate the summer camp.

There are several components to the mission and strategic planning. The directors need to establish the mission, communicate it with the organization's members and stakeholders, and review it periodically to ensure that it is appropriate. A mission, if it is to be used to guide the organization's subsequent decision-making, will be an important statement and the board should consider the level and type of consultation it will undertake with the members, its employees, clientele, funders and the public. There ought to be a significant degree of up-front buy-in or comfort if the mission statement is to be accepted and become effective. The board also needs to develop strategic plans to implement the key elements of the mission statement; mission statements, like organizations themselves, can only become a reality to people being served through actions.

The board also needs to consider what the risks are and how to manage those risks. Any action involves risk and the board has a duty to anticipate risks, to understand those risks, to address them and to manage them. The board does not have a duty to avoid all risks; the only way to do so would be to do nothing in life, which defeats the very purpose for the organization to exist.

The board needs to oversee and monitor the mission on a regular basis. It can do so by establishing measurable goals. The panel preferred "desired outcomes" or "impacts" over "inputs or activities" but it is not always clear how this can be accomplished. These goals are part of the tools of governance, which are discussed in another chapter.

2. *Transparency and Communication*, which help to ensure that the organization's activities are open and transparent and that there is communication between the organization and its members

and stakeholders. This communication should be both ways. Openness and transparency, however, should not preclude appropriate confidentiality. For example, a board should not normally negotiate the purchase of a building in public, permitting the seller to know what the board's bottom line price is.

Transparency and communication includes a number of elements. The board should establish policies for communication and feedback with stakeholders, a code of ethical conduct, and a complaints and grievance procedure that is effective. The board must meet regularly for discussion of matters and the making of decisions. Proper minutes and other documents must be kept to maintain the collective memory. Indeed, for corporations, the board has an obligation to do so and all organizations must do so under the *Income Tax Act*.⁸ The organization should also respond appropriately to requests for information, recognizing that different requesters will have a different level of access to such information.

3. *Organizational Structures* should reflect the needs of the organization and its culture. Some organizations are part of a larger federation of organizations and its structure will likely be different from a stand-alone organization. Size and activities will also dictate differing structures. For example, a large organization may want an executive committee with decision-making powers. Care must be taken to ensure compliance with any legislative requirements or restrictions around committees. For example, if an executive committee is to be established, the Ontario *Corporations Act* has specific requirements that need to be in place. Furthermore, only an executive committee under that Act can make decisions; all other committees can at most be advisory.

⁸ R.S.C. 1985 (5th Supp.), c. 1.

The panel recommended that the structure reflect at least three elements: (i) that the board be capable of objective oversight, (ii) that there be an independent nominating committee to ensure appropriate succession of the board, and (iii) that an audit committee be established. The purpose of the audit committee would be to report on whether or not the organization is complying with the laws, rules, regulations and contracts that govern it and to review whether the management, information and control systems are organized and implemented to carry out these rules and regulations. The audit committee is also responsible for supervising external financial reporting. Whether there is one committee or more will be dependent on each organization.

This type of structure may not be appropriate for most organizations. The size of the organization and the scope of its operations may suggest a less sophisticated approach to organizational structure. Each organization needs to develop its own approach, and the more sophisticated approach may be more in keeping with a policy governance board model than one in which the board makes most of the decisions.

4. *Board's Understanding of Its Role* requires that the board members have a shared understanding of the role of the board and of the directors, officers and staff. An effective board is a major method to prevent problems from occurring and to address those when they do occur. The success or failure of an organization is dependent upon the board understanding its role and carrying out that role — however that role has developed in law or in practice. The effectiveness of a board of directors is discussed below.
5. *Fiscal Responsibility* is a cornerstone of accountability. This topic is reviewed in more detail later, but a number of matters should be highlighted. The board must ensure that the organization

is in a financially sound position and that it has the resources necessary to carry out its activities.

If these two objectives are not possible, the board has two options from which to choose:

- locate and put in place the resources that are necessary; or
- alter the organization's programs to fit the resources that are available.

While any human activity — not-for-profit or for-profit — is not without risk, the board should not put the assets of the organization at unnecessary or unknown risk. Risk is part of life but the board needs to know and understand the likely risks and put in place the tools to minimize and manage those risks.

The directors have both statutory and common law duties towards the organization and often to third parties to ensure that the organization is operated in a financially prudent manner. These duties are sometimes referred to as some of the “fiduciary duties” of directors. The board, in fulfilling its duties, ought to put in place:

- a budget that is based on the mission and strategic plan of the organization and its priorities, consistent with its legal obligations and limitations, and on a realistic estimate of revenues and expenses;
- mechanisms to monitor and control expenditures. These mechanisms will normally include the accounting books and records that are required to be kept by law and by generally accepted accounting principles, financial statements (including audited statements where required) and reports on a regular basis. In the case of a registered charity, the *Income Tax Act* establishes certain requirements for record-keeping;
- tools to ensure that the assets of the organization are managed appropriately and consistently with the organization's legal obligations and that any liabilities do not become excessive or unmanageable.

Boards too often fail to devote the resources that are necessary to ensure that prudent financial practices occur. However, without the resources being available and properly managed, the organization cannot fulfil its objectives and the underlying purpose of the organization is not possible. Human nature being what it is, it is also to financial prudence that others look in making their decisions about an organization. Organizations that become insolvent or that have substantial losses due to defalcation or misuse of funds that could have been avoided are not trusted. The voluntary sector operates on the basis of “trust” — both trust in its legal sense and in its human sense.

6. *Oversight of Human Resources* is necessary because human resources are an important asset of the organization. Human resources includes staff and volunteers. The oversight of human resources requires the directors to ensure that the human resources have appropriate skills, training and backgrounds for the positions they occupy. Proper recruitment processes, job descriptions and performance appraisals are the responsibility of the directors — either directly or through management staff reporting to the directors. These processes ought to be fair and open.

The board must also ensure that the organization complies with the various statutory schemes that are in place, including employment legislation, workplace safety, labour legislation, collective agreements, and human rights codes. There should be codes of conduct, including conflicts of interest. Appropriate screening processes should be in place for both staff and volunteers, especially where they deal with children, the elderly or vulnerable in the community.

7. *Assessment and Control Systems* are based in large measure on the accounting books and records. However, the systems often include codes of ethical conduct, an effective monitoring

and complaints procedure, a framework for internal regulations (such as a constitution or by-laws), compliance audits and an evaluation of the board as a whole.

8. *Planning for Succession and Diversity* is important for organizations. In addition, organizations should reflect the diversity of the community in which they operate.

These concepts are not new but restated for a changing Canada. Others have articulated similar tasks in slightly different ways.⁹ In one case, the author identified the following ten “responsibilities” of directors:¹⁰

- determine the mission;
- select the executive;
- support and evaluate the executive;
- lead planning;
- secure adequate resources;
- manage resources;
- set and monitor programmes;
- public relations;
- “court of appeal”;
- self-assessment.

⁹ See, for example, M.A. Paquet, R. Ralston & D. Cardinal, *A Handbook for Cultural Trusts* (Waterloo Ont.: University of Waterloo Press, 1987); and S. Kreiger, *Duties and Responsibilities of Directors of Non-Profit Corporations* (Toronto: Canadian Society of Association Executives, 1989).

¹⁰ R.T. Ingram, *Ten Responsibilities of Non-Profit Boards* (Washington: National Center for Non-profit Boards, 1988).

Each of the tasks can best be managed through an understanding of the skill-sets available to the organization within the board and staff structure. The skills of each of the individuals should be taken into consideration in determining where responsibility for addressing the tasks should lie. Some believe the role of the board of directors is strictly limited to raising funds; but this approach means ignoring the reach into and understanding of the community that a director brings. It also ignores the skills that each director has which are available to improve the organization. Ultimately, within the legal constraints, there should be a mutually beneficial working relationship for the betterment of the organization.

The increased skills of professional staff may lead to changes in how the board and senior staff interact. Staff will often be driven by the strategic planning process – not to exclude the directors but because the staff should have the information to assist the board in making good decisions. The board members, if properly recruited, will bring knowledge within their expertise, which includes information about the community. The relationship between staff and board ought to be one of collaboration and mutual respect rather than an adversarial one. Just as staff should be recruited based on the needs of the organization and the skills the individual brings to the position, so should board members. It should be clear what each board member's skills are, what his or her areas of knowledge and expertise are, and what he or she ought to contribute to the organization. Staff need to understand that while they may have more knowledge and specific expertise in certain areas, especially where there is complexity in the context in which the organization operates or where change is rapid, the role of the board is critical to the long term success of the organization.