

POLICY BASED GOVERNANCE – WHAT WORKS AND WHAT DOESN'T

By Donald J. Bourgeois, B.A., LL.B.

Counsel to Carters & Associates

A. INTRODUCTION

There is an ongoing discussion or debate about “policy governance” and “administrative governance” and which one is better than the other. This discussion sometimes misses the point; rather than deciding which is better, the focus should be on what will work or not work for a specific organization. This article will briefly define “policy governance” and “administrative governance,” review standards of care for directors and officers, examine factors for boards of directors to take into account in determining governance approach that works for their organization and review policies that ought to be in place for most organizations.

B. WHAT IS GOVERNANCE?

“Governance” is a combination of both 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 and involves the active oversight by the board of the organization’s governance.

There are two conceptual approaches to “governance” and “stewardship.” The more “traditional approach” is the “Administrative Governance Model.” In this model, the board makes most substantive decisions based on materials and discussion at board meetings. The other model is the “Policy Governance Model” with which the board has an “oversight” role rather than active role in managing affairs of the organization. This approach relies more on the development of operational policies which are implemented by staff and officers.

There is also a third model, often called the “Carver Policy Governance” model. It is a variation or different type of governance model. It assumes that the board of directors represents the “interests of the owners.” This assumption is a difficult one to implement, especially in the charitable sector, where the directors are to manage the affairs of the organization so that it may achieve its charitable objectives.

The Carver model makes a distinction between “Ends” and “Means.” The board is to establish the “Ends” and staff develop the “Means” to accomplish those “Ends.” The board determines, through monitoring, whether or not those “Ends” are accomplished and, if so, the “Means” used by staff worked. Under the Carver model, there are four categories of policy – Ends, Executive Limitation, Governance Policy and Board/Staff Linkages.

The reality is that most organizations will – and should – operate on the basis of a mixture of two models. There is a spectrum between “administrative governance” and “policy governance” resulting from several factors, including:

- ◆ legal authority of the directors, officers and organization itself;
- ◆ statutory or common law obligations or restrictions or contractual obligations;
- ◆ constating documents;
- ◆ culture of organization;
- ◆ views and perspectives of key stakeholders;
- ◆ skills, competence and training of staff and volunteers;
- ◆ resources;
- ◆ size and type of operation;
- ◆ activities carried out by the organization; and
- ◆ due diligence requirements of the directors and officers.

Directors have a statutory and common law duty to manage the affairs of the organization. There is, however, no clear articulation of what is meant by “manage the affairs.” Likely, it is more than monitoring.

The Panel on Accountability and Governance in the Voluntary Sector reviewed governance and the role of the board of directors. It concluded that there were several areas that were the responsibility of the board. These areas include:

- ◆ Mission and Strategic Planning;
- ◆ Communication;
- ◆ Organizational Structures;
- ◆ Board's Understanding of Its Role;
- ◆ Fiscal Responsibility;
- ◆ Oversight of Human Resources (staff and volunteers);
- ◆ Assessment and Control Systems; and
- ◆ Planning for Succession and Diversity.

The way each board of directors fulfills its responsibilities will, of course differ depending upon the organization and its context.

C. DIRECTORS' DUTIES

Directors owe duties to the organization. These duties will vary, depending upon the nature of the relationship. The case law identifies a number of relationships that are relevant:

- ◆ Fiduciary relationship (corporate law)
 - to act with a reasonable degree of prudence
 - to be diligent
 - to act in good faith, honestly and loyally
 - to avoid conflicts of interest
- ◆ Trustee or "Akin-to-Trustee" (charitable law)
 - to exercise vigilance, prudence and sagacity
 - to act in good faith
 - duty not to delegate
 - duty not to have conflict of interest

The Ontario Public Guardian and Trustee identified the following duties of directors of charities:

- ◆ to be reasonable, prudent and judicious;
- ◆ to carry out the charitable purposes;
- ◆ to avoid conflicts of interests;

- ◆ to act gratuitously;
- ◆ to account; and
- ◆ to manage the charity's assets.

Directors will also owe duties arising from various statutory and regulatory requirements. A large number of statutes impose duties on directors with respect to employees and the workplace, taxation and other imposts, environmental protection, business practices, competition, information and personal privacy, intellectual property and vulnerable clients.

D. STANDARD OF CARE

There are also standards of care for directors in meeting or carrying out these common law and statutory duties. Statutes, common law and contracts impose duties on directors and set out standards of care for directors. There is a potential for personal liability if the applicable "standard of care" is not met.

Unfortunately, there is no clear "standard of care" or single standard of care that is applicable in all circumstances. The standard of care may vary depending upon the specific statutory duty, the individual's background, training and experience, the type of activity, legal status of the organization (trust, unincorporated association, corporation, statutory corporation) and as between "not-for-profit" and charitable (trustee or "akin to trustee").

The standard of care is generally subjective in nature. The classic articulation of this standard of care is in the early 20th century case of *Re City Equitable Fire Insurance Co*. The judge commented that the degree of skill required from a director is what "may reasonably be expected from a person of his knowledge and experience."

In the late 20th century, the court commented in *Canada v. Corsano* about what seemed to be an objective standard of care in a statute:

All directors of all companies are liable for their failure if they do not meet the single standard of care provided for in subsection 227.1(3) of the Act. The flexibility is in the application of the standard of care since the qualification, skills and attributes of a

director will vary from case to case. So will the circumstances leading to and surrounding the failure to hold and remit the sums due.

The standard of care for directors of charitable organization is more complicated. In *Re Public Trustee and Toronto Humane Society et al*, an Ontario court commented:

Whether one calls them trustees in the pure sense (and it would be a blessing if for a moment one could get away from the problems of terminology), the directors are undoubtedly under a fiduciary obligation to the Society and the Society is dealing with funds solicited or otherwise obtained from the public for charitable purposes. If such persons are to pay themselves, it seems to me only proper that it should be upon the terms upon which a trustee can obtain remuneration, either by express provision in the trust document or by the order of the court.

Another court, in *Asian Outreach Canada v. Hutchinson*, noted:

The confusion has sometimes arisen is a consequence of the fact that the equitable jurisdiction of the Court includes both the enforcement of trusts and the supervision of charities whether the latter are established under wills or trust instruments inter vivos, or as corporations. As many of the general principles applied by the courts in supervising charitable trusts have also been applied to charitable corporations there was a tendency, particularly in 19th Century cases in England, to find the basis of the jurisdiction over charities in the law of trusts. This does not appear to be correct historically and it is clear that it does not represent the present state of the law in this jurisdiction.

There is confusion over the “standard of care,” especially for directors and officers of charitable organizations. Directors need to be prudent in deciding upon the governance approach for an organization and to be able to defend that choice and how the approach is implemented. The approach should meet the needs of the organization and will likely, to some degree, include “policies.”

E. WHAT ARE “POLICIES”?

A policy is a governing principle. It allows the board to delegate to others (staff, volunteers, agents) the authority to act on behalf of the organization. Board control over the implementation of a policy is essential. A policy allows staff, volunteers, agents and others to know what the board wants and expects and why.

A policy is intended to accomplish a number of things. These objectives are:

- ◆ to bring a reasoned approach to a particular matter or issue;
- ◆ to provide for consistency and overall fairness and predictability to decisions;
- ◆ to encourage full consideration of all relevant factors before a decision is made on the merits of a particular matter; and
- ◆ to carve out areas of specific responsibility and accountability so that those who know the job best are the ones who have the responsibility to do it.

There are a number of policies that are common among charitable and not-for-profit organizations. The following lists various policy documents that most directors will be familiar with (or ought to be) in performing their functions:

1. Governance Policies

- ◆ letters patent, memorandum of association, trust deed or similar constating documents
- ◆ by-laws
- ◆ board structure and decision-making processes (e.g., committees)
- ◆ rules of procedures or rules of orders
- ◆ conflict of interest policy
- ◆ communications policy
- ◆ access to information and protection of privacy policy

2. Strategic Planning

- ◆ mission statement
- ◆ statement of goals and objectives
- ◆ business plans
- ◆ budgets and resource allocations

3. Operational Policies

- ◆ financial management (cash management, internal procedures, banking arrangements, internal audit)
- ◆ compliance management (including regulatory compliance)
- ◆ human resource management (management, staff, volunteers)
- ◆ program management
- ◆ asset protection (insurance and indemnification)
- ◆ investment policy

There are several steps to the development of a policy. The policy process includes:

- ◆ identification of need for a policy – experience, legal requirement (e.g., *Occupational Health and Safety Act, Trustee Act*);
- ◆ terms of reference for policy development, format and research;
- ◆ review of legal requirements and standards that are applicable;
- ◆ drafting of policy;
- ◆ discussion of draft policy and preparation of final version;
- ◆ approval by the board;
- ◆ development of implementation plan;
- ◆ approval of the implementation plan, which may require resource allocation;
- ◆ evaluation of policy and its effectiveness; and
- ◆ revision of policy.

F. CONCLUSION

Most organizations will have “policies” in place that are used by the board and/or staff to guide decision-making. The degree to which policies are required will vary depending upon the type of organization, its size and operations, its resources, and statutory or contractual obligations. Boards of directors, regardless, must “manage the affairs” of the organization and cannot simply delegate to others.

Donald J. Bourgeois acts as counsel to Carter & Associates and is the author of “The Law of Charitable and Not-for-Profit Organizations, 1st, 2nd and 3rd Editions,” “Charities and Not-for-Profit Fundraising Handbook,” “Charities and Not-for-Profit Administration and Governance Handbook” and “Public Law in Canada” published by Butterworths Canada.