
CERTIFIED GENERAL ACCOUNTANTS PD SEMINAR

Ottawa – March 6, 2007

Good Governance 101

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OVERVIEW OF TOPICS

- Understanding Duty of Care
- Director Duties and Liabilities
- The Importance of Good Governance
- Operational Due Diligence
- Structural Considerations

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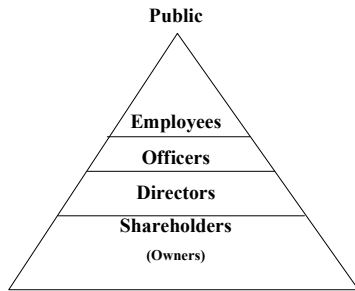
INTRODUCTION

- Organization is a legal artifice used for practical purposes – allowing people to structure their internal relationships and external dealings with others in an efficient and effective manner
- Organizations may be unincorporated associations, corporations (with or without share capital), cooperative corporations, trusts

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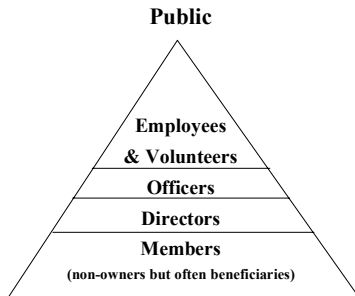
DIFFERENT TYPES OF CORPORATIONS

- **Share capital corporations**
(business corporation to make a profit)



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- **Not-for-Profit Corporations**
(non profit purpose but not charitable)



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- **Charitable Corporations**
(charitable purpose akin to a public trust)



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A director is generally anyone who takes on the role of the directing mind of a corporation, while an officer carries out the day to day functions of the corporation at the direction of the board

- Directors are responsible for making sure that the organization:
 - Relates to people in accordance with the law
 - Acts in a fiscally prudent manner
 - Is efficient and effective in achieving its purposes

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UNDERSTANDING THE DUTY OF CARE

- Directors of all corporations must exercise certain standard of care in carrying out duties
- Standard of care varies depending on type of corporation and incorporating statute
 - Business corporation
 - Statutory objective standard of care: Reasonably prudent person
 - Directors need to ask: How would a “reasonably prudent person” conduct the affairs of the corporation?

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- Not-for-profit corporation (non-charity)
 - Common law subjective standard of care
 - Director’s own knowledge and experience important
 - Directors need to ask: What level of skill and care can reasonably be expected from a person with my knowledge and experience?
 - New *Canada Not-for-Profit Corporations Act* will establish an objective standard of care

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– Charitable corporation

- Additional expectations beyond subjective standard
- Courts in Ontario have held that directors of charities are also subject to fiduciary duties as quasi-trustees of charitable property
- Directors need to ask: What level of care would a reasonable and prudent person managing his own affairs exercise?

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COMMON LAW DUTIES AND LIABILITIES

- Management of the Corporation
 - Directors are responsible for all aspects of corporations operations
 - To fulfill duties, directors must ensure:
 - Objects are properly carried out and activities comply with objects
 - Corporation’s financial stability and overall performance
 - Proper hiring and supervision of management and staff
 - Failure to act, i.e. inaction, can result in personal exposure to liability i.e. liability of Worldcom directors

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- Liability Risk for Lack of Corporate Authority
 - Corporate authority defined by corporate objects in governing documents
 - All corporate activities must fall within parameters of these objects
 - Liability results where directors act outside scope of this authority

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- **Liability Risk for Negligent Mismanagement (Tort)**
 - Tort is civil wrong for which injured party can seek damages from the court
 - Directors can be personally liable for corporation’s torts where own conduct or inaction contributed to victim’s injury
- **Liability Risk in Contract**
 - Directors generally not personally responsible for contracts signed for corporation
 - However, need to have proper corporate authority to sign contracts and ensure contractual terms are complied with

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- **Vicarious Liability**
 - The doctrine of vicarious liability imputes liability to an employer or principal of a tortfeasor, not on the basis of fault of the employer or principal, but on the ground that as the person responsible for the activity or enterprise in question, the employer or principal should be held responsible for loss to third parties that result from the activity of the enterprise

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- Public policy considerations weigh heavily in imputing liability on this basis –i.e. who gains from the enterprise that gives rise to the loss should pay for damages sustained
- In *Blackwater v. Flint*, the Supreme Court held that the Church exerted sufficient control over the operations of the School that gave rise to the wrong to be found vicariously liable for the conduct of the dormitory supervisor

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- Court confirms that vicarious liability may be imposed where there is sufficient nexus between the conduct authorized by the employer and the wrong committed by the employee or agent
- Moreover, vicarious liability can be imposed even though the wrongful act may be contrary to the desires and policies of the organization

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- Liability Risk for Breach of Fiduciary Duty
 - Overview
 - Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property
 - Directors of not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest
 - Fiduciary duties owed to charitable objects, corporation, donors, members and creditors

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- Summary of fiduciary duties
 - Duty to act honestly
 - Conflicts of interest to be avoided and disclosed
 - Directors must not act fraudulently
 - Duty of loyalty
 - Director's sole interest is to the corporation
 - Director's interests not to be placed in conflict with those of corporation

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- **Duty of diligence/duty to act in good faith**
 - Directors to diligently attend to duties by being familiar with all aspects of corporation
 - Directors may have liability exposure at common law for failure to attend to their legal duties or those of the corporation
 - Where necessary, advice of qualified professionals should be sought
- **Duty to exercise power**
 - Directors responsible for managing corporation

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- Delegation to management, staff and volunteers is possible, but directors must always supervise
- **Duty of obedience**
 - Directors must comply with applicable legislation and the corporation's governing documents
 - All valid corporate decisions must be implemented

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- **Duty to avoid conflict of interest**
 - Conflicts of interests to be avoided
 - Directors must also avoid anything that gives director appearance of a personal benefit
 - Where conflicts occur, they are to be declared, director to not participate in discussions or vote, and may even have to resign

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- **Duty of prudence**
 - **Directors with special expertise must use it prudently to achieve best result for corporation**
- **Duty to continue**
 - **Resignation as director will not relieve all obligations**
 - **May even constitute breach of trust**
 - **Independent legal advice should be obtained in considering resignation**

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- **Liability for Breach of Trust**
 - **In addition to fiduciary quasi trustee duties, directors of charitable corporations may also be trustees of some charitable property**
 - **However, fiduciary duties and trustee duties essentially the same**
 - **Recent *Aids Society* case emphasizes that directors have obligation to apply charitable property to charitable objects**
 - **Where charitable property lost as a result of actions or inactions of directors, breach of trust could be found**

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STATUTORY DUTIES AND LIABILITIES

- **Overview**
 - **Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors**
 - **Directors can be held personally liable, as well as jointly and severally, with other directors**
 - **Only defence is due diligence**
 - **Resigning as a director may not limit liability though there are generally limitation periods**

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- **Federal Statutes**

- *Canada Corporations Act*

- **Wages and vacation pay**
- **Conflict of interest**
- **Reporting requirements**
- **Books, minutes and records**
- **Identification of corporation**
- **Membership lists**
- **Winding up**
- **General penalty**

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- *Income Tax Act (Canada)*

- **Directors jointly and severally liable to pay employee income tax deductions for two years after term of office**
- **Directors may be personally liable if charity fails to comply with numerous reporting requirements, e.g. annual charity information return, improper charitable receipts, or giving improper tax advice**
- **Directors may also face fines and imprisonment if they are involved in making false or deceptive statements or evading compliance with the *Income Tax Act***
- **Avoid liability by showing positive steps taken to ensure compliance**

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- *Excise Tax Act (Canada)*

- **Directors jointly and severally liable for corporation's failure to collect & remit GST**
- **Liability continues for two years after cease to be director**

- *Canada Pension Plan*

- **Joint and several liability where corporation fails to remit employee pension premiums**

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– *Canadian Environmental Protection Act*

- Positive duties imposed on directors to ensure compliance in relation to air and water pollution as well as toxic substance storage and disposal
- Failure to comply could result in prison terms and fines

– *Anti-terrorism Legislation*

- Legislation has serious liability risks for charitable corporations and directors, particularly those involved in overseas work

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- Risks include seizure of charitable property, loss of charitable status and *Criminal Code* charges
- See www.antiterrorismlaw.ca

– *Criminal Code*

- Bill C-45 (Westray Mines) for negligence in work place safety
- Section 336 – criminal breach of trust

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- Ontario Statutes
 - *Corporations Act (Ontario)*
 - Wages and vacation pay
 - Directors jointly and severally liable to employees for all debts due for services performed for the corporation
 - 6 months wages and 12 months vacation pay is maximum
 - Reporting requirements
 - Conflict of interest
 - General offence provision

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– *Retail Sales Tax*

- Directors jointly and severally liable where corporation fails to remit

– *Workplace Safety and Insurance Board Act (Ontario)*

- Directors are not liable for corporation’s failure to remit premiums unless it can be shown they did not intend to pay them

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– *Pension Benefits Act (Ontario)*

- Directors who fail to pay corporation premiums for employee’s pension plans and to hold monies in trust may be ordered to make up contribution
- Failure to comply may subject directors to fines

– *Ontario Health Insurance Program*

- Directors will be held personally liable for premiums and health tax not paid by corporation

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– *Occupational Health and Safety Act (Ontario)*

- Directors required to take reasonable steps to comply with workplace health and safety requirements
- Failure to do so will result in fines to corporation and its directors

– *Environmental Protection Act (Ontario) and Related Legislation*

- Directors required to take reasonable care to prevent unlawful discharge of contaminants

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- Persons in control of contaminants are responsible for cleanup and related costs
- Appropriate environmental audits need to be obtained before purchasing or receiving land
- *Child and Family Services Act (Ontario)*
 - Failure to report child abuse is an offence
 - A charitable corporation and its directors may be liable where employees fail to report abuse or where it occurs because of failure to monitor employees and operations

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- *Trustee Act (Ontario)*
 - Act establishes that directors of charitable corporations have power and duty to invest assets of charity
 - Investments must be in accordance with prudent investor standard
 - See Charity Law Bulletin #8 at www.charitylaw.ca
- *Charities Accounting Act (Ontario)*
 - Act gives rights to donor and Public Guardian and Trustee (PGT) to call directors to account for improper use of

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- Charitable property as well as fundraising practices
- Commingling of donor restricted funds is permitted provided there is strict compliance with the act's requirements
- *Human Rights Code (Ontario)*
 - Possible discrimination against employees
 - Possible discrimination against members of the public, i.e. sexual orientation, as well as possible new exemption involving denial of same sex marriages for religious organizations

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IMPORTANCE OF GOOD GOVERNANCE

- **Good governance is the primary role of the board of directors and is critical to managing risk effectively**
- **The board cannot look to others to achieve good governance**
- **Good governance is not “perfection” – intended to minimize the risk of things going wrong, identify what may go wrong and prevent it, and address problems when things go wrong in a legal and ethical manner**

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What is Governance

- **“Governance” is a combination of overall processes and the structures that are used in directing and managing the organization’s operations and activities**
- **Two conceptual approaches to “governance”**

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Administrative Governance Model

- **“Traditional approach”**
- **Board makes most substantive decisions based on materials and discussion at board meeting**

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Policy Governance Model

- Board has “oversight” role rather than active role in managing affairs of the organization
- Approach relies more on development of operational policies implemented by staff and officers

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Reality

- Most organizations will – and should – operate on the basis of a mixture of the two models
- Spectrum between “administrative governance” and “policy governance” based on several factors
 - Legal authority of directors, officers and organization itself
 - Statutory or common law obligations or restrictions or contractual obligations
 - Constatng documents

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- 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

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OPERATIONAL DUE DILIGENCE

Boards and Directors

- Decisions are made by the *Board of Directors* and not by individual directors or groups of directors
- Decisions are articulated through resolutions
- Once decisions are made, the “corporation” has spoken through the *Board* - this is the concept of “corporate authority” of directors

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Operational due diligence requires directors to exercise due diligence on all levels of operation and in a pro-active manner

1. Directors need to know and understand governing documents of the corporation
 - Directors must not authorize *ultra vires* activities
 - Membership/governmental approval may be required for certain corporate actions

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2. Directors should understand their rights/ obligations at board meetings
 - Right (duty) to attend board meeting
 - Directors must be prepared for meetings
 - Directors have equal voting rights
 - Need to record contrary vote
 - Must declare conflict of interest

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3. Directors should carry out their duties in a way which reflects their ultimate responsibility for corporate operation

- Directors should be proactive in management
- Directors have right of access to property of corporation and to inspect and copy books, corporate records and other documents
- Directors have a fiduciary duty to protect charitable assets

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4. The board should establish policy

- 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
- Policy allows staff, volunteers, agents and others to know what the board wants and expects and why

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- When and to what extent can directors delegate?
 - Can delegate day to day operations, including officer duties
 - parameters of authority of “delegatee” should be defined in by-laws or in policy
 - But directors must require accountability and exercise their authority
 - Regardless of delegation, directors retain their fiduciary duties and corresponding liability

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What Types of Policies Are Common?

- **Governance Policies**
 - Letter 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

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- **Strategic Planning**
 - Mission statement
 - Statement of goals and objectives
 - Business plans
 - Budgets and resource allocations

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- **Operational Policies**
 - Financial management (cash management, internal procedures, banking arrangements, internal audit)
 - Compliance management
 - Human resource management (management, staff, volunteers)
 - Program management

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Policy Process

- **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 a policy**
- **Discussion of draft policy and preparation of final version**

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- **Approval by the board**
- **Development of implementation plan**
- **Approval of the implementation plan, which may require resource allocation**
- **Evaluation of policy and its effectiveness**
- **Revision of policy**

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Selected Policy Documents

- **Conflict of Interest**
- **Code of Conduct**
- **Personal information and Privacy**
- **Human Resource and Workplace Policies – occupational health and safety, harassment and discrimination, hiring and retention**
- **Financial Management and Overview**
- **Regulatory Compliance Management**

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- **Asset Protection – insurance and indemnification (officers and directors, general liability, professional or other activity/client specific insurance)**
- **Fiscal Management**
- **Program Review**
- **Investment Policy (charitable property)**
- **Program Policies**

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- 5. Directors should seek out and take advantage of training/educational opportunities and ensure participation by senior staff:**
- **In the area of the corporation’s current operation**
 - **Changes in the law affecting directors’ duties**
 - **Corporate and tax laws affecting organization**

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- 6. Directors of charities should monitor and require reports regarding fundraising program and compliance with ITA obligations**
- **Monitor fundraising appeals**
 - **Understand director obligations regarding restricted gifts**
 - **Review and enforce terms of restricted and endowed gifts**
 - **Ensure gifts are used for charitable purposes**

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7. Directors are entitled to and should rely on advice

- **Internally (Management)**
 - **In anything but a very small organization, directors will generally need to engage a staff person or manager to oversee operations**
 - **Directors should receive and review reports from management at every board meeting**
- **Externally (Outside professionals)**
 - **Relying on professional advisors like accountants and lawyers provides evidence of due diligence**

8. It can be helpful for boards to use due diligence checklists

- **Legal Risk Management Checklist**
- **Sexual abuse checklist**
- **Fundraising compliance due diligence checklist**
- **Insurance checklist**

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