Not-for-Profit Governance Fundamentals: Board Basics for the NFP Director

Rayna Shienfield

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Preface

Directors of not-for-profit organizations (NFPs) are often not otherwise involved in the not-for-profit sector and take on this responsibility as a way to "give back." However, becoming a director of an NFP is a significant responsibility, and it must be undertaken with care. After all, the board is at the top of the organizational structure and ultimately responsible for the oversight and strategic direction of the organization. As such, before joining an NFP board, potential directors should be equipped with knowledge about:

- the not-for-profit sector (including how it differs from the for-profit sector)
- how NFPs are organized
- the role and responsibilities of NFP boards and directors
- the lifecycle of the board

The Corporate Oversight and Governance Board (The Board) of Chartered Professional Accountants of Canada (CPA Canada) has developed this guide to help new NFP directors understand these basics of NFP governance and the sector. The Board acknowledges and thanks the members of the Not-for-Profit Committee for their invaluable advice and the author, Rayna Shienfield. A special thank you is extended to Don Taylor, Nicole D'Aoust, Jane Burke-Robertson, Richard LeBlanc, Linda Mollenhauer, Laura Cassiani and Paula Pettit, the authors of CPA Canada publications on which this guide is based.

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Table of Contents

Introduction

There are over 165,000 NFPs in Canada.[1] They address a broad range of needs and interests in areas including arts and culture, sports and recreation, education, hospitals and health services, human and social services, environment, civil rights and religion, as well as business and professional associations.

NFP organizations range in size, scope and resources from small, grassroots all-volunteer groups to large, well-resourced educational, health and international agencies.

The board of directors is at the top of the organizational structure. It is responsible for the oversight and strategic direction of the organization. Directors have a fiduciary role as stewards of the organizations' resources and are also responsible for hiring and evaluating the CEO or executive director. In some organizations, directors may also be referred to as trustees, governors, etc.

SPECIAL STATUTES: One example of a special statute is that each of the provincial accounting bodies in Canada is constituted under its own legislation, such as the *Chartered Professional Accountants of Ontario Act*, 2017 or the *Chartered Professional Accountants Act* (BC), 2015.

Before joining the board of an NFP, individuals should have an understanding of the not-for-profit sector, how NFPs are organized, the role and responsibilities of NFP boards and directors, and the life cycle of the board. The goal of this document is to provide the basics that a potential director should know before joining a board.

Understanding the Not-for-Profit Sector

1. How are NFPs structured?

NFPs can be incorporated, or they can be structured as unincorporated associations or trusts.[2] The organizational structure will affect the powers, duties and liabilities of the organization itself as well as those of its directors.

Corporations

A corporation is an entity recognized by the law as having its own separate identity. While a for-profit corporation has share capital and a purpose of benefiting its shareholders, incorporated NFPs are non-share capital corporations whose goals do not include gain or profit for its members (although in some cases members can benefit – for example, a sports club).

1 Blumberg, M. (2018, May 17). Key statistics on Canada's charity and non-profit sector. *CanadianCharityLaw.ca*.

2 NFPs can also be structured in other ways, such as cooperative corporations, but this is less common.

NFPs may be incorporated pursuant to either federal or provincial legislation, and – depending on the jurisdiction – under corporate legislation, not-for-profit corporations legislation, or under legislation established by a special statute. The legislation sets out certain duties, responsibilities and liabilities of the corporation's directors.

Unincorporated associations

An unincorporated association is a group of individuals that come together for a common purpose. The association has no legal identity separate from the people who make up the association. Unincorporated associations are not established and governed under a statute.

Trusts

A trust is not a legal entity, but the relationship between a group of persons (trustees) who hold property that must be used for the benefit of specific persons or purposes. In the case of charitable trusts, the property must be used for charitable purposes or public benefit. The powers and duties of the trustees are spelled out in the trust document and in provincial trustees' legislation.

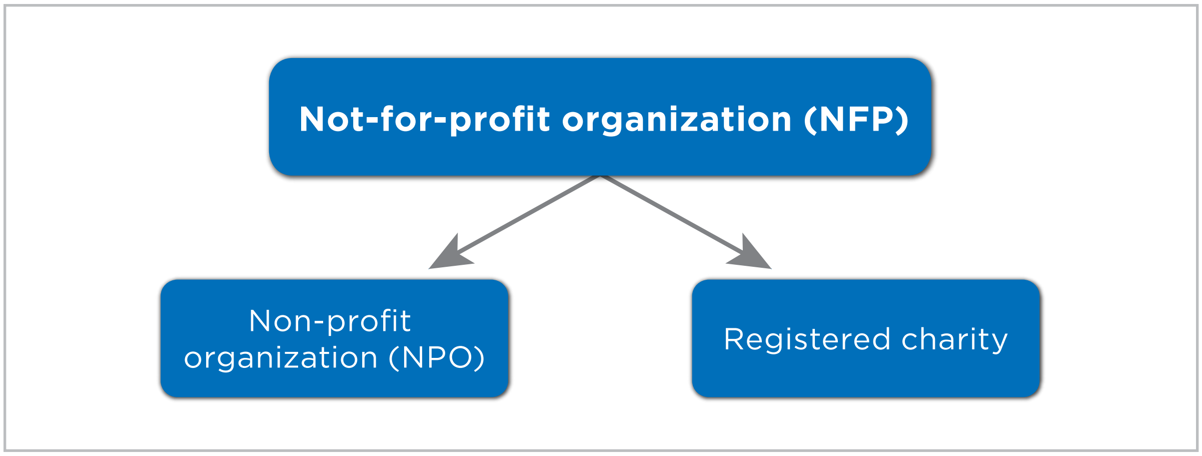
2. What is the difference between a registered charity and a non-profit organization?

Whether or not an NFP incorporates, it can register as a **charity** under the *Income Tax Act*. To obtain registered charity status, the NFP must use its resources for charitable activities and have exclusively charitable purposes. Status as a registered charity can provide benefits to the organization, but it also imposes additional obligations on the organization and its directors. A registered charity is distinct from a **non-profit organization (NPO)**. While a non-profit *corporation* may register as a charity, the *Income Tax Act* defines a non-profit *organization* as an association or corporation that is not a charity and is organized for any purpose other than profit.

The term **not-for-profit organization (NFP)** is an umbrella term commonly used to include both non-profit organizations and charities.

MORE ABOUT REGISTERED CHARITIES:

About 86,000 of the NFPs operating in Canada are registered as charities under the *Income Tax Act*. To qualify as a registered charity, an organization must be established and operated for charitable purposes (advancing religion, advancing education, relieving poverty, and other purposes that benefit the community), and it must devote all of its resources to charitable activities, including making gifts to qualified donees. The charity must be established and resident in Canada, and it cannot use its income to benefit its members. A charity also has to meet a public benefit test. Registered charities are also subject to additional legal and reporting requirements.



3. What differences are there in size and scope of NFPs?

NFPs vary widely in size. At one end of the spectrum are small organizations, which may be entirely volunteer-run or have only a few paid staff. They may have no physical business premises, limited revenues and little organizational structure. At the other end of the spectrum are NFPs whose size dwarfs many public companies, employing hundreds or thousands of people out of numerous locations and managing substantial revenues and investments.

In terms of scope, many Canadian NFPs operate at a local or regional level. Others, however, have a national presence or may form part of a larger national or international organization.

4. What are the key differences between the for-profit and not-for-profit sectors?

Goals and objectives

The most obvious difference between the corporate sector and the not-for-profit sector is the motivating factor. The goals of organizations in the not-for-profit sector generally focus on providing services or benefits to members or clients, or they focus on furthering a cause.[3,4] The objectives will generally be set out in the documents that establish the organization.[5] Any excess revenues are not withdrawn from the organization for the benefit of its owners, but rather they are retained and used to further the organization's stated purpose.

3 Taylor, Don. (2021). *Governance for not-for-profit (NFP) organizations: Questions to ask (2nd edition)*. CPA Canada, p.8.

4 NFPs can generally be divided into two categories: mutual benefit and public benefit. Mutual benefit NFPs are accountable to their members in a direct way – their purpose is tied to benefiting members. In public benefit NFPs, the members are more like supporters than beneficiaries of the NFP's activities – in these cases the directors need to demonstrate accountability to the NFP's "public" rather than to its members.

5 Supra note 3 p. 10. These were previously known as the "charter" or "letters patent." Today, these could be "articles of incorporation," "articles of continuance" or "letters patent," depending on the jurisdiction.

Funding

NFPs may have a variety of funding sources. Some are funded largely by grants from government or foundations. Others solicit funds from the public. Funds obtained in this manner may be subject to restrictions on how they may be used. In addition, some NFPs (such as professional associations) may be funded by member fees, and others obtain some or all of their funding from fees for products or services that they provide.

Stakeholders

NFPs work with a wide range of stakeholders, some of which are particular to the not-for-profit sector. Stakeholders may include clients or customers served by the organization, members or supporters of the organization, paid staff, volunteers, community partners, funding agencies, donors, government, business sponsors, and the community in which the organization operates. Good stakeholder relations are critical to success, and require careful management, as diverse stakeholders may have different (and potentially conflicting) expectations of the organization.

Use of volunteers

Many NFPs rely extensively on volunteers, who may be involved in the operations of the organization or in its management, as well as on the board. The vast majority of directors of NFPs serve as volunteers. In many cases, directors are prohibited from receiving remuneration for their services.

Performance measurement

Performance measures used by boards and other stakeholders of NFPs are different from those applicable in the for-profit sector. Rather than financial results, the overarching measure for NFPs is whether the programs and services that the organization is delivering move it closer to accomplishing its mission. Ultimately, the performance being measured is whether the organization is making a difference to the people, communities and causes it serves, given the resources entrusted to it.

> For more information on program evaluation for NFPs, see CPA Canada's *Board Oversight of Not-for-Profit Program Evaluation: Questions for Directors to Ask*.

Accounting standards

Private sector NFPs have different options for financial reporting. These NFPs have the choice of adopting either International Financial Reporting Standards (IFRS) in Part I of the *CPA Canada Handbook – Accounting* (*Handbook*), or accounting standards for NFPs in Part III with these latter standards supplemented, when appropriate, with standards for private enterprises in Part II of the *Handbook*.

Alternatively, NFPs controlled by a government fall within the scope of the *CPA Canada Public Sector Accounting Handbook*.

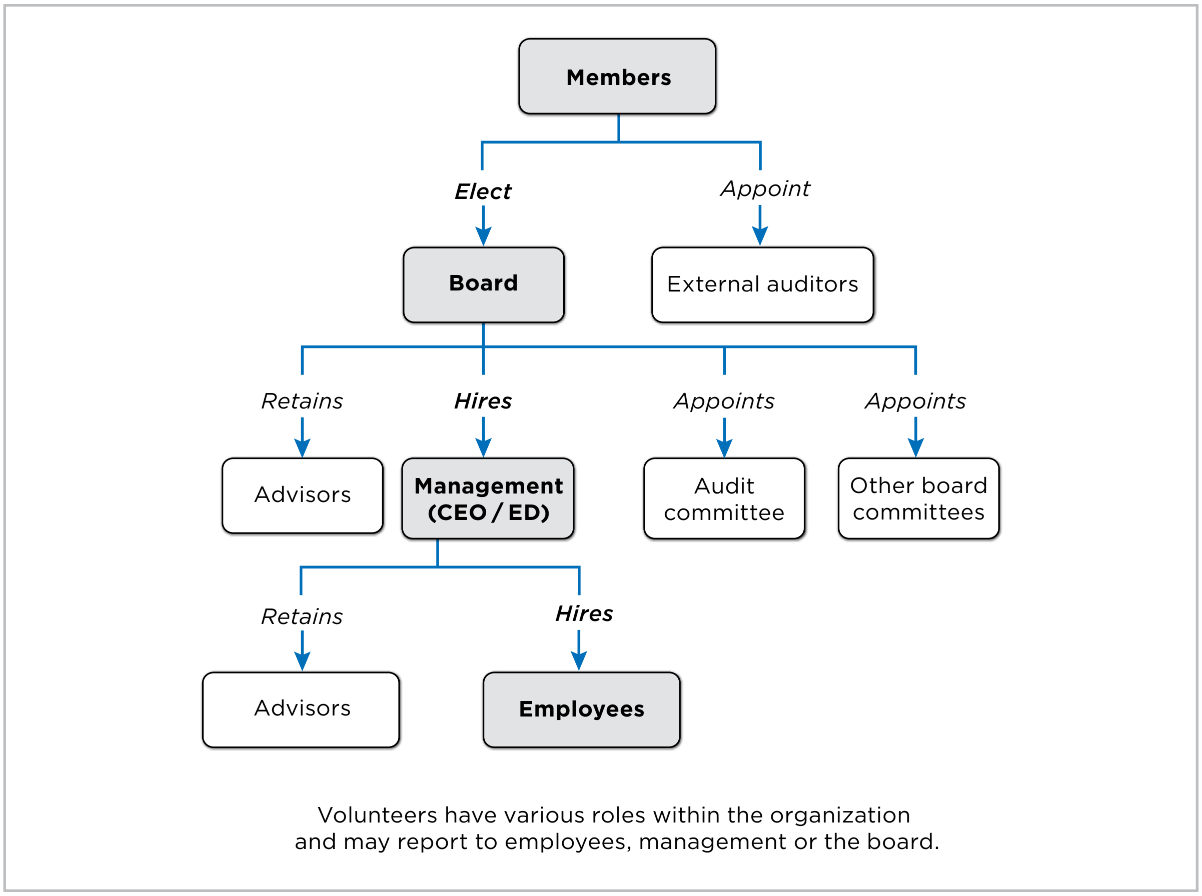
Organizational Structure

5. What is the relationship between the board, members, management and employees?

All incorporated NFPs in Canada operate under the *Canada Not-for-Profit Corporations Act*, similar provincial legislation, or a special statute. Implicit in the legislation is a generic governance framework with clear relationships:

- The board of directors is elected by the members of the NFP.
- As the senior oversight entity, the board appoints the CEO/ED.
- Management hires employees to operate the organization.

GENERIC GOVERNANCE FRAMEWORK[6]



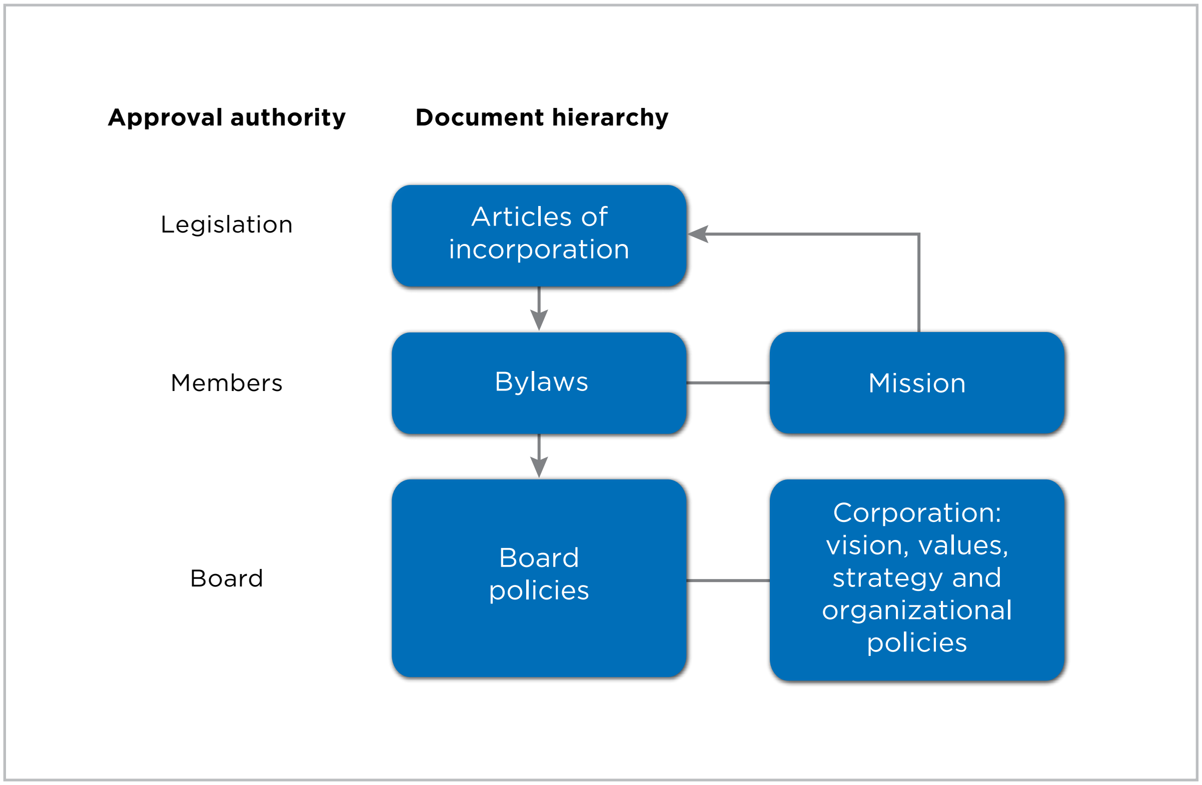
6 Ibid. p. 9.

6. What is the relationship between an NFP's incorporating documents, by-laws and board policies?

The legislation establishes a hierarchy of authority for the NFP's governance. The documents within this hierarchy are as follows:

1. **the NFP's incorporating document**,[7,8] which sets out the NFP's purpose and the terms and conditions of incorporation; if the NFP is a charity and/or receives government funds, the articles of incorporation may also include provisions relevant to protecting the public trust and ensuring public monies are used for their intended purpose
2. **the NFP's bylaws**, which set out the outline for the governance of the NFP including the rights of members and the scope of the board's authority
3. **board policies**, which describe the board's governance framework: how it will exercise its authority, meet its responsibilities and manage its affairs

GENERAL GOVERNANCE AUTHORITIES[9]



7 Ibid. p. 9.

8 See footnote 5 for information on incorporating documents.

9 Supra note 3 p. 10.

The Role of the Board

7. What are the overarching duties of the board and of individual directors?

The legislation and common law related to governance embody two fundamental principles:

1. The **board** is responsible for all aspects of the organization, including overseeing its operations and holding management accountable for delivering on the mission of the organization. Boards are required to make decisions that are in the organization's best interests. In reaching a decision, the board must be able to demonstrate that it took into account the decision's impact on the NFP's members[10] and various other stakeholders.[11]
2. Each **individual director** on the board has duties to the organization. The two main duties are the:
   - *duty of care* – to act with competence and diligence
   - *duty of loyalty* – to act honestly and in good faith in the best interests of the organization

A more detailed description of these duties is discussed in question 13.

In this context, it is important to recognize that a director's *role* is as a part of the board, but their *responsibility* is as an individual. A director cannot delegate this responsibility.

8. Are there different kinds of directors?

A "true" director of an NFP is an individual who is elected or appointed to sit on the board of directors of the organization and who has voting privileges as a director. Sometimes, people are referred to as ex-officio directors, honorary directors, or members of advisory boards. The roles and responsibilities of each of these categories is distinct.

Ex-officio directors: Ex-officio directors qualify as directors by virtue of an office they hold, rather than being chosen through a selection process. An example of an ex-officio director would be someone

For additional information on the standard of care, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask about Director's Duties*.

10 See footnote 4 for information on accountability of public benefit NPOs.

11 Courts will not second-guess a board's decision if directors discharged their responsibilities in reaching the decision and the board has followed a sound decision-making process, which includes taking into account the decision's potential impact on various stakeholders.

who holds the role by virtue of being a named representative (such as the president) of another organization. Some organizations give ex-officio directors the right to vote; others define them as non-voting.[12]

Honorary directors: An honorary director is an appointed, non-voting position. This term is often used to refer to an individual who is given the title as appreciation for past service.

Members of advisory boards: Members of advisory boards are appointed to give non-binding strategic advice to an organization. Because they have no substantive authority over the organization, they do not have fiduciary responsibilities to the organization.

In summary, whatever title is given, a "director" who does not have voting privileges is not a director and does not have the same duties and responsibilities as a voting director. That being said, if a non-voting director or other individual acts like a voting director, making decisions along with the rest of the board, there is a risk that he or she could be found by a court to be subject to the same duties and other obligations (as well as liabilities) as a "true" director.

For more information on the relationship between the board and CEO/ED, see question 5

The separation of board and management roles is one of the most important features of a good organizational governance framework. The work of the board is to see that the organization's mission gets accomplished. Directors should not do the organization's work. They typically lack the time and operating expertise of paid employees, who can do the work more efficiently. Further, doing or managing the day-to-day work undermines the independence checks and balances of the board's oversight role.[13]

9. How does a board operate?

For organizations with staff, the board can be seen as having one employee: the CEO/ED. The organization reports to the board through the CEO/ED, and the board oversees the organization through the CEO/ED. Within this structure, NFPs can use different governance models to separate the roles of the board and management. Three common models are:

1. traditional model
2. Carver Policy Governance® model (the "Carver model")
3. results-based model

12 In recent legislation, such as the *Canada Not-for-profit Corporations Act*, and in contemporary standards of good governance, the practice of permitting ex-officio or other non-elected individuals the right to vote on governance matters is often prohibited or discouraged.

13 Supra note 3 p. 15.

Traditional model – hands-on board

This model offers a relatively informal, transitional framework for governance. Board and management roles are formally separate, although they may become blurred. For example, board committees often mirror organizational functions (e.g., finance, operations, public affairs) and individual directors often work jointly with management to advance organizational projects. This model requires the board to have a deep understanding of the NFP's operations and gives management direct access both to the operational expertise of the directors and to their extra hands.

Carver model – focus on policy to shape board work

This model offers a formal, structured and disciplined framework for governance. It relies heavily on board policies to guide the work of both the board and management. Responsibility for policy is assigned to the board; responsibility for operations is assigned to management. In other words, the board's obligation is to see that the NFP achieves its intended ends, while the board delegates the responsibility to management for carrying out the acts to achieve the ends. Many of the NFP's organizational policies and decisions take the form of board policies entitled "executive limitations." The responsibility for ends focuses the board on the emerging external trends and issues that affect the NFP's ability to accomplish its mission and on the outcomes for communities served.

Results-based model – focus on results to shape board work

A hybrid of the traditional and Carver models, this model offers a formal, structured and disciplined governance framework in which the board relies as much on its directors' judgment as it does on policy in doing its work. Under this model, board and management roles are formally separate, with the board focusing on results or outcomes. The board measures results using a theory of change. Board decisions rely on an understanding of how the NFP does its work without overreaching into management's operational domain ("noses in, fingers out").

"Noses in" means the board and each director understand the organization's strategy and operations in sufficient detail to:

1. **understand its risks and potential opportunities and**
2. **oversee how management mitigates the risks and leverages the opportunities.**

"Fingers out" means that the board neither manages the organization nor does management's work.[14]

10. How do the board and directors relate to the CEO / executive director and staff?

The board is seen as having one employee: the CEO/ED. The CEO/ED is responsible for direct management of the organization and its staff.

14 Ibid. p. 16.

However, the directors retain overall responsibility for overseeing the organization's human resources – which include not only staff but also volunteers, interns, agents and independent contractors. This responsibility extends to overseeing the organization's overall HR strategy and ensuring compliance with all legal requirements related to HR. It is expected that management will keep the board apprised of HR developments, though directors should also proactively seek the information necessary to satisfy themselves that their understanding is sufficient to oversee the organization's human resources appropriately.

Effective relationships between the board and the CEO/ED require mutual trust and openness. When a board delegates authority to management, it should feel confident to let them manage without interference. In return, the CEO/ED must respect the organization's values as they carry out the strategies approved by the board, and keep the board informed of progress and problems.

Although the board should let staff manage, there is often value in providing opportunities for directors and staff members to become better acquainted and to share information and experiences. Strategic planning retreats and social events help develop trust and openness. This can be reinforced by inviting staff to make presentations at board meetings and encouraging them to be appropriately frank in their comments and answers.

11. How do board committees work?

A board may act as a committee of the whole on all issues for which it is responsible, or it may delegate responsibility for specific issues to a committee or an individual director (as a committee of one). A board may appoint as many committees as it feels necessary, with each committee chaired by a director.

Committee roles and responsibilities depend on the needs of the organization and the board's approach to governance, which should be reflected in its terms of reference that the board approves.

Committee charters describe the responsibilities that boards delegate to committees, such as:

- oversight over the organization's assets, financial structure, investments, risk management, internal controls, preparation of financial statements and (where appropriate) the audit of the financial statements (finance, investment or audit committee)
- the selection, compensation and succession of the CEO and other senior staff (compensation or human resources committee)

- board process and performance, including the selection and assessment of directors, recommendation of new or revised board policies, and review of by-laws (governance or nominating committee)
- oversight of strategic planning and performance (planning or finance committee)
- other areas that require attention and oversight by the board, such as membership, fundraising, resources, quality and safety, information technology, community relations or professional discipline

While the board may delegate responsibilities to committees, these committees review, recommend and report back to the board for approval. The board retains ultimate oversight responsibility for the organization.

12. What does a board's work look like over the course of a year?

Regular board meeting frequency varies widely across the not-for-profit sector, from semi-annually to quarterly to monthly (or near monthly). Factors that influence the frequency of board meetings include the complexity of the NFP's work; the maturity of the board, the NFP and its management team; and force of habit. Unless an organization is a start-up or in survival mode, a board should be able to accomplish its work with well-planned and well-organized quarterly meetings, an annual meeting and board retreat. The example below is based on quarterly board meetings and a fiscal year that starts on April 1:[15]

Board meeting	Topic	Action
Q1 (April)	Fundraising plan	Approve
	Board development	Develop improvement plan based on board effectiveness survey
	Director nominations	Approve
	CEO performance	Conduct annual review and set goals for current year
	Board committee recommendations	Approve
	Annual accountability report to funder(s)	Approve

15 Ibid. p. 41-42.

Board meeting	Topic	Action
Annual meeting* (June) *this is a members' meeting, not a directors meeting	Audited financial statements	Approve
	Annual general meeting	Agenda and motions Elect board Elect leaders for board and board committees
	Board development	Conduct new director orientation
Q2 (July)	Board annual work plan	Approve
	Key performance indicators	Review
	Financial statements	Review
	Board committee work plans	Approve
	Board and organizational policies	Review and revise as necessary
Q3 (October)	Key performance indicators	Review
	Financial statements	Review
Board retreat (November)	External scan	Discuss sector and stakeholder issues and opportunities
	Strategic plan	Review and approve
	Board development	Board and management team meeting
Q4 (January)	Key performance indicators	Review
	Financial statements	Review
	Investment performance	Review
	Investment mandate	Confirm
	Annual operating plan and budget	Approve

Directors' Duties and Risks

13. What is a fiduciary duty, and what does it mean for directors?

Directors of non-profit organizations and charities are fiduciaries. A fiduciary is a person who has a legal duty to act primarily for another person or organization's benefit and who (a) owes another person or organization the duties of good faith, trust, confidence and candor and (b) must exercise a high standard of care in managing another's property. Fiduciary duties are imposed by the law to protect those who are vulnerable from those who have power over them. Fiduciaries must put the interests owed to the other person or organization above their own.

Why are directors in a fiduciary relationship? Because of the position they occupy within the organization. The assets belong to the organization, and the assets can only be managed through its directors. This means that in an NFP, the board of directors owes a fiduciary duty to the organization. Directors of charitable organizations owe a fiduciary duty to the charitable purposes of the organization, the charity itself and – some would argue – even to the charity's donors.

Directors' duties can be divided into two main branches: the duty of care and duty of loyalty.

- **Duty of care:** Directors have a duty of competence – a requirement to act with a certain level of skill in making decisions for the organization. The duty of care describes the level of attention required of a director and can be described as a "duty to be informed" and to act with competence and diligence. The law does not require directors to be experts, but rather that they act in accordance with a particular standard of care. Generally, a heightened duty of care is owed by directors of a charitable organization, which means that directors on the board of a charity must take additional care and attention.
- **Duty of loyalty:** The duty of loyalty (also known as the fiduciary duty) requires that a director act honestly and in good faith in the best interests of the organization. The duty of loyalty is a personal duty and cannot be delegated (the "no-delegation rule"). In other words, directors cannot delegate their fiduciary duty to management, staff or volunteers of the organization. The duty of loyalty also means, among other things, that a director is not allowed to profit from their office and must avoid all situations in which their duty to the organization conflicts with their interests or duties to others (the "no-conflict" rule). Unless sanctioned by the board, directors must not share the confidential business of the corporation outside meetings of the board.

The standard of care for directors of not-for-profit corporations varies across the country. This means that in some provinces and territories, the standard is that of "a reasonable and prudent person in the same circumstances" (an "objective" standard), whereas in other provinces and territories, the director's specific knowledge or skills are considered (a "subjective" standard).

For additional information on the standard of care, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask about Director's Duties*.

14. What is my risk of liability as a director and how can I manage the risk?

Directors of NFPs are at risk of personal liability arising from three areas:

- Directors who breach their duties may be personally liable if the organization suffers a loss that can be attributed to the actions or omissions of directors.
- Directors may be liable for torts committed in their role as directors (i.e., a negligent or intentional civil wrong that injures someone in some way).
- There are a number of statutes that may impose liability on directors for failures in areas including government reporting requirements, unpaid wages and source deductions, environmental mishaps, and occupational health and safety. These potential liabilities will depend in part on the type of organization and on the applicable legislation.

Much of the potential liability to which directors are subject can be minimized by diligence in the fulfillment of their duties. To minimize sources of liability, directors should satisfy themselves that the board regularly reviews the status of the organization's policies and procedures that require directors, staff and volunteers to:

For additional information on the standard of care, see CPA Canada's *20 Questions Directors of Not-for-Profits Should Ask about Human Resources*.

- act within the scope of the governing policies of the organization
- comply with the laws, rules and regulations that apply to the organization
- protect the assets of the organization
- provide a relatable accounting of the organization's financial condition
- take steps to protect third parties from harm or damage caused by the organization's activities

Additionally, it is important to remember that a decision made by the board of directors – whether a majority, two-thirds, or some other level of decision-making – means that the board has spoken on behalf of the organization. Every director is responsible for the decision, whether or not the director is present at the meeting. That the board has made this decision also means that every director is liable (along with the remaining directors) should a loss occur as a result of its decision.

Accordingly, if a director disagrees with a decision the board has made, it is important for them to voice their objection at the meeting and to ensure that the director's dissent is recorded in the minutes of the meeting. A properly recorded dissent may, depending on the circumstances, result in the director limiting their personal liability. If a director is unable to attend a meeting, they should obtain copies of the minutes and any materials considered at the meeting and, after reading the minutes, be sure to immediately state any objection they may have in writing to the secretary or chair.

Additional protection for directors is available in the form of indemnities and insurance.

Indemnity

Directors may have the right to be reimbursed by the organization for the amount of a judgment or similar award resulting from civil, criminal or administrative proceedings arising out of acts or omissions while they were acting within the capacity of director. This reimbursement includes the cost of defending the director, but it does not include non-financial items such as pain and suffering or loss of reputation. A director's right to indemnification will be determined by the governing legislation, the by-laws of the organization and any contract between it and the director. In addition, there are some limitations on the ability of registered charities to indemnify directors.

Insurance

Directors' and officers' (D&O) liability insurance is an important source of protection to directors in the exercise of their duties, and this insurance can protect directors in situations where indemnity may not (for example, where indemnity is not permitted or where the organization does not have funds available to indemnify directors). Most D&O policies cover claims arising from acts or omissions while acting in the capacity of director, or claims against a director by virtue of their position. D&O insurance should address the costs of defence against legal action as well as cover legal judgments.

It is important to check that your organization has D&O insurance and to understand the extent to which it protects you. Director liability is a complex area and D&O policies have a number of exclusions. If directors have any questions or concerns, they would be wise to get advice from legal counsel.

15. What should a director do if faced with a conflict?

Directors' duty of loyalty requires them to act honestly and in good faith with a view to the best interests of the organization. Directors should not profit from their office and should avoid situations in which their duty to the organization conflicts with their own interests or duties to others. A conflict of interest can develop in two general ways:

- a personal conflict between the director's duty to act in the best interest of the organization and the director's own self interest
- a conflict of duties that the director owes to the organization versus those it owes to another organization

Before joining the board of an NFP, prospective directors should consider whether their personal interests or duties owed to another organization might lead to a conflict of interest that would prevent them from fulfilling their duties to the not-for-profit organization and, thus, from joining the board. For example, directors of a charity may not benefit, directly or indirectly, from the charity. Once on the board, where possible, directors should avoid conflicts of interest. However, should a conflict of interest arise:

Accountants who provide audit services must adhere to requirements of legislation, standards of their governing body and rules of their audit firm with respect to independence. Accountants generally cannot be a director of any entity that is an audit client of their firm. In addition, accountants should be alert to business relationships or other factors that might appear to put their independence at issue.

- Where the conflict arises at a board meeting, a director should immediately declare the conflict and abstain from voting (and, if necessary, recuse themselves from the meeting).
- Where the conflict, or potential conflict, arises outside of a board meeting, the director should take the following steps as soon as possible:
  - Review the organization's conflict of interest policy to determine whether there are specific requirements or an identified process that they must follow for declaring a conflict and, if so, who the designated person is that they should report the conflict to.
  - Consider the organization's governing legislation to determine if it addresses the declaration of a conflict of interest.[16]

16 Some not-for-profit legislation in Canada provides a narrow exception to the no-conflicts rule, where a director has an interest in a contract or proposed contract with the organization, declares the conflict and follows the process outlined in the legislation. It is important to understand that, depending on the province in which the charity operates, this kind of statutory exemption is not generally available to directors of charities. Because of the premise that charities are there for the public good, directors or charities must avoid any interest in a contract unless court approval is given ahead of time.

  — Speak to the designated person the conflict-of-interest policy identifies (or, failing that, the chair or vice-chair) about the nature of the conflict, particularly where the director is unsure if a conflict truly exists.
- Where the conflict places the director in a situation in which they believe they cannot act in the organization's best interests as a result, they should resign.

The Board Life Cycle – Selection Through Renewal

16. How are directors selected?

Finding the right people to serve as directors is usually the responsibility of the nominating and governance committee, where one exists. It otherwise falls to the whole board. The committee recommends new directors to the board for approval. The board, in turn, proposes candidates that the members may elect. Employees of the organization may have suggestions for potential candidates; being employed by the organization does not preclude someone from putting names forward to the committee or the board for consideration.

For additional information on the standard of care, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask about Recruiting, Developing, Assessing and Renewing Directors*, page 3.

Two primary methods exist for selecting directors: appointment and election. They may be used individually or in combination. The legislation used to create the organization, and its constating documents, typically set out the requirements regarding the composition and selection of the board of directors.

CONSTATING DOCUMENTS: **an organization's incorporating document, constitution and/or by-laws**

A successful director recruiting process results in qualified individuals, free from material conflicts of interest, joining the board. They express a strong commitment to serve, oversee and advance the organization. The process achieves a smooth succession of directors (including board and committee leaders) that balances new ideas and energy with experience and institutional memory.

DIRECTOR COMPETENCIES: **skills, knowledge, experience, education and training possessed by a director**

To make informed decisions, an effective board relies on directors with diverse competencies. The competencies a particular organization requires depend on the current state of the organization, its future direction, its industry or sector, the need for leadership on the board, as well as specific functional areas of expertise (such as accounting). The committee or board often uses a competency matrix, which compares the skills and experience of current directors to the competencies needed by the board. This identifies gaps that the board should fill through the director selection process.

Organizations may also conduct a values screen to assess whether the values of the organization and the prospective director are aligned, and a behaviour screen to ensure optimal board dynamics. Boards also need to satisfy themselves that a prospective director has the desired background, qualifications and values and has no undisclosed conflicts of interest or reputational issues that could put the organization at risk.

17. What type of orientation should be provided to directors?

Like employees and volunteers, directors benefit from an orientation process that introduces them to the organization and their role in it. While most organizations recognize this orientation process as a best practice that enables new directors to contribute to the greatest extent from the outset, if an orientation is not offered, a new director should take it upon themselves to request one.

The executive director and other staff can provide valuable information about the organization and the environment in which it operates. The primary source for information on governance or the board, however, should be the board chair, governance committee, other experienced directors or an external subject matter expert, rather than staff.

Directors need to understand the organization’s purposes, governance processes, strategic plan, revenue model (including revenue sources and expenses), compensation practices, financial management oversight, accounting standards, stakeholder accountability and regulatory developments. They also need to understand the challenges facing the organization in these and other areas, as well as its strategy for risk, governance and management.

Orientation information for new directors may include:

- board and committee responsibilities and work plans
- board operations, dynamics and culture
- the organization’s strategic and operating plans
- the organization’s risk appetite framework
- the organization’s budgets, investments, financial statements and audits
- the code of conduct and policies on conflicts of interest, whistleblowing, confidentiality and communication

- all governance documents, including constating documents, guidelines and terms of reference, and board and committee minutes and meeting materials from the recent past

18. What types of ongoing training do directors need?

The needs of the board, committees and individual directors will drive the nature and extent of ongoing learning. Ongoing learning may be in the form of structured learning (continuing education), experience or mentoring.

For more information on director training, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask About Recruiting, Developing, Assessing and Renewing Directors*, page 17.

Continuing education

Structured learning can occur at regularly scheduled board and committee meetings through staff explanations and briefings, commentary by the board chair or committee chairs or presentations by external experts. Director education can also include visiting facilities operated by the organization, using online learning portals and attending external conferences, seminars and formal director education certification programs such as those offered through the Institute of Corporate Directors or The Directors College.

Experience

Experience as a director, just on its own, can improve effectiveness. This type of education may include learning from board or committee chairs about how to lead and how to conduct effective meetings and create a culture of constructive challenge and support.

Leading practice sees board and committee chairs regularly renewed (e.g., every two or three years). Boards commonly have prospective leaders progress up the ladder of officer or other positions (such as from vice-chair to chair). This practice familiarizes these individuals with the position and helps hone their skills before they assume responsibility for leading the board.

Mentoring

New directors can benefit from mentoring by high-performing directors during their first few years on the board. Mentoring directors can offer candid feedback to their mentees before, during or after board meetings on how they could contribute more effectively.

19. How is the performance of the board and individual directors assessed?

Regular assessments of the board, its committees and individual directors help ingrain continuous improvement in these groups and improve the board's effectiveness. Individual assessments can also inform whether a director continues to serve on the board.

In practice, boards often address performance informally. For example, directors can use roundtable discussions at the end of board meetings to assess meeting effectiveness. Boards and committees may also assess and improve specific practices and procedures when problems arise or after receiving a suggestion for a better approach. Board and committee chairs may provide informal feedback and mentoring to encourage directors who contribute well and want to improve or to address issues with under-contributing ones.

However, NFP boards are increasingly adopting more explicit, accountable and transparent assessment processes because they want to improve their effectiveness at the board, committee and individual director levels. These assessment processes set clear responsibilities and criteria for participating, reporting and follow-up.

In some cases, NFPs may use independent governance consultants to conduct assessments. They account to the committee (or board) and can set objective criteria, support the review process, provide feedback and recommend actions. Some consultants focus on providing services to smaller NFPs; however, the cost of this option makes this impractical for some smaller or cash strapped organizations, or organizations worried about how donors will react to this use of funds.

For more information on director assessment, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask About Recruiting, Developing, Assessing and Renewing Directors*, page 23.

BOARD ASSESSMENT CRITERIA MAY INCLUDE:

- leadership
- procedures and resources
- quality of information flow among senior management, the board, committees and directors
- board dynamics
- relationships among the board, the board chair, the executive director, other senior staff and stakeholders

20. How should director renewal occur?

Regularly refreshing a board with new directors, a best practice, ensures the board has fresh perspectives, and helps keep the board current.

Implementing term limits is a governance practice that calls for directors and chairs to serve a maximum number of years after which they must resign. For example, directors could be eligible to serve for three terms of three years to a maximum of nine years on the board. Many boards renew their directors via term limits, and several countries have moved toward mandatory term limits for for-profit company directors.

However, good practice calls for renewal to be contingent on director performance assessments that link tenure to performance, not time. When peer assessments identify an underperforming director or chair, this feedback must be acted on. If the individual does not improve after the board offers them a chance to do so, the director may be asked to resign or not have their term renewed.

For more information on director renewal, see CPA Canada's *20 Questions Directors of Not-for-Profit Organizations Should Ask about Recruiting, Developing, Assessing and Renewing Directors*, page 28.

DIRECTOR ASSESSMENT CRITERIA MAY INCLUDE:

- whether they fulfill the position description requirements (e.g., attendance, preparing for meetings, participating in discussions, committee service)
- whether they contribute the expected competencies
- the nature of their contribution
- the personal qualities and behaviours that contribute to board effectiveness
- their participation in fundraising (if expected)

Where to Find More Information

CPA Canada publications on not-for-profit governance: available at www.cpacanada.ca/nfpgovernance

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Rayna Shienfield is a principal of Corporate Oversight and Governance at CPA Canada. Under the direction of CPA Canada's Corporate Oversight and Governance Board and Not-for-Profit Governance Committee, Rayna oversees activities focusing on improving the quality of governance in the corporate and not-for-profit sectors by providing pragmatic, forward-thinking guidance for boards of directors.

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