

Chapter 4: For boards and directors

Volunteers and the Law

A guide for volunteers,
organizations and boards

2000 Edition

Once elected, a board of directors assumes responsibility for the affairs of the organization and owes a duty of trust to participants and volunteers, to each other as board members, to the organization's staff, to members of the organization, and to anyone who may be affected by the acts of the board. Directors also have a duty to comply with the law under a variety of statutes.

Directors must use skill and care in managing the organization, be honest, and work in the organization's best interests. Failure to comply with these duties can make the organization or the board liable for damages, and can sometimes result in the personal liability of individual directors.

In this chapter you will find:

- an introduction to the [liability of boards](#) and directors
- an overview of some basic legal [duties of boards](#) and directors, and
- [prevention checklists](#) for boards and directors.

Liability of boards and directors

Directors' liability is becoming more and more of a threat to organizations. Historically, the directors of incorporated organizations were shielded against certain liability. Indeed, that is often the main reason why organizations incorporate: to avoid personal liability for those running the organization. Corporate laws are structured so that a company is liable for certain things, but the staff, volunteers and directors are not (in most situations)

personally liable. There are exceptions to this rule.

Over the last 15 years or so, this corporate shield has been eroded or pierced by the courts. Case law has evolved so that directors can be held personally liable in a good number of situations (which are described below). At the same time, more lawsuits have been brought against directors, officers, employees and volunteers of corporations. In addition, new statutes have been created that impose personal liability on directors and officers.

As a result, organizations have been forced to think about ways to manage risk – in terms of both prevention and cure. Although claims against nonprofit board members are rare, the fear of potential liability grows. The important thing is to understand the duties of directors and officers, assess potential liability, try to prevent the liability as much as possible, and obtain insurance if needed.

Personal liability for the organization's financial obligations

In some circumstances, directors of nonprofit organizations may be personally liable for the organization's financial obligations.

For example, directors of unincorporated organizations will almost certainly be held personally liable for the organization's debts.

Directors of incorporated nonprofit organizations receive protection from liability under statutes like the Canada Corporations Act, and B.C.'s Society Act. However, failure to comply with the requirements of these statutes may result in directors being held personally liable. For example, under the Society Act directors may become personally liable if the society has fewer than three members for more than six months. Directors may also be personally liable if they cause (or allow) a society to act beyond the scope of its authority, as defined by the act and the organization's stated purposes in its constitution and bylaws.

Directors can also be held personally liable if they have breached their duties, for example if they have misused funds, made improper loans, or made unlawful personal profit in the course of their duties as directors.

In addition to these obligations, directors may be personally liable for financial obligations imposed by specific statutes, such as the Employment Standards Act, or the Income Tax Act.

Duties of boards and directors

As explained earlier, a duty is a legal obligation to do certain things or to act in a certain manner. Every person has duties under the law.

Volunteer directors of boards owe legal duties to the organization, its participants and volunteers, each other as board members, the organization's staff, members of the organization, and anyone who may be affected by the acts of the board. Failure to comply with these duties can make the organization or the board liable for damages, and can sometimes result in the personal liability of individual directors.

As explained in [Chapter 1](#), some legal duties have evolved through the courts over time. Other duties are specifically set out in written law, known as statutes. Boards of directors of nonprofit organizations have specific duties under the law once they become incorporated as societies under statutes like B.C.'s Society Act, or Part II of the Canada Corporations Act. These statutes impose strict duties onto boards and individual directors.

Some important legal duties of boards and directors are discussed in this chapter:

- Fiduciary duties, including:
 - duty to perform with diligence, care and skill
 - duty to act with prudence
 - duty to avoid a conflict of interest
- Duty to maintain the organization's legal status
- Duty to employees, and
- Duty to act within scope of authority.

*board duties
delegated
to staff -
Duty to
operate
the*

Although staff may carry out activities, manage programs or administer the organization on a daily basis, ultimately it is the board of directors that owes the duty to operate the organization. The board is responsible for overseeing the day-to-day operations of the organization, and is also responsible for setting and implementing policies, and ensuring that the objectives of the organization are met.

The board is also responsible for ensuring that specific statutory duties are met, such as holding annual general

organization meetings or filing returns with Revenue Canada.

The board may ask staff to help with these duties.

**What if
a decision
is made
while a
director
is absent
from a
meeting**

Individual directors may not be liable for decisions made while they were absent from a board meeting. However, if a director knew that a decision was being made, but chose to stay away so as not to be part of the decision, then it might be argued that the director has given unspoken consent to the action.

In a situation like this, a prudent director will have his or her dissent recorded. For example, a director can attend the next meeting and, when a motion is put forward to adopt the previous meeting's minutes, ask that his or her dissent be added to the record.

**Fiduciary
duties**

Volunteer directors of nonprofit organizations owe a duty to act in good faith and in the best interests of the organization. These duties are known as directors' fiduciary duties.

Fiduciary duties have both evolved through common law and been specifically set out in statutes. Under B.C.'s Society Act, for example, these duties are defined as follow:

A director of a society must:

- a) act honestly and in good faith and in the best interests of the society, and
- b) exercise the care, diligence and skill of a reasonably prudent person in exercising the powers and performing the functions as a director.

For example, in most cases directors would be found to have failed in their fiduciary duty if they used their position on the board to:

- create profit for their own business
- use the organization's funds for their own purposes
- accept a fee from a company for help to win a contract from the organization
- compete with the organization (even after they have left the board), or

- fail to disclose conflicts of interest (for example, that a recipient of funds was a good friend).

Directors' broad fiduciary duties include many specific duties. Three are examined here:

- Duty to perform with diligence, care and skill
- Duty to act with prudence, and
- Duty to avoid a conflict of interest.

Duty to perform with diligence, care and skill

Fiduciary duties require each director to act with the diligence, care and skill of a reasonably prudent person.

In the past, directors might have been seen to have occasional duties performed at periodic board meetings. Modern courts have imposed a higher duty of care. Directors are expected to attend meetings and be prepared for the business at hand. They are expected to make reasonable inquiries into the day-to-day management of the organization, and participate in decision making. They should not rely on the opinions of others, but ask questions and be certain they are making appropriate decisions. They should play an active role in overseeing the day-to-day affairs of the organization and ensure they have selected responsible managers.

Directors who have special skills or expertise, such as lawyers or accountants, have a further duty to practice a standard of care equal to their professional abilities. For example, a director of a society who is also a chartered accountant will be expected to apply his or her expertise when reviewing financial statements. A director who is a small business owner would apply her own experience to reviewing the financial statements and ask for clarifications if necessary.

However, if a director is unable to understand the financial statements of the organization, it is not appropriate to remain in ignorance and rely on the lack of skill for protection. It is a director's duty to ensure that the statements are understood by asking questions and insisting on full explanations.

A board member who reasonably believed he understood the financial statements, or who relied on false explanations from other directors, would probably not be liable for the other people's fraud or negligence, provided

they had no reason to suspect the explanations were false and were otherwise doing their job conscientiously.

Duty to act with prudence

Fiduciary duties require each director to act prudently when managing the organization. Prudent directors are cautious and careful, and try to foresee the consequences of a course of action before taking it. This duty imposes a legal obligation on directors to avoid taking unreasonable risks.

For example, directors may be found to have failed to act with prudence if they engaged in risk-taking such as:

- approving expenditures when the organization lacks the funds to cover them (deficit spending)
- approving the purchase of property for the organization's use when there is an inadequate income to cover the monthly mortgage payments
- investing the organization's funds in risky investments, such as stocks, rather than in secure investments like term deposits, or
- deferring management to the president of the board without the reasonable supervision of the board.

Directors of a profit-making corporation can and must take business risks with company funds in order to make a profit and they will not be liable for any financial losses that result merely from an error in judgment. The directors of a nonprofit organization, however, have no reason to take any risks with the organization's funds because their task is not to make profits but to manage the organization's funds carefully and wisely. Taking financial risks would generally not be prudent management of a nonprofit organization.

A director who is careful and cautious and who avoids financial risks will probably meet the duty of prudence.

Duty to avoid a conflict of interest

Fiduciary duties require directors to avoid being conflicted between the interests of the organization and their own personal interests.

Whenever a director has a personal interest in the same subject matter as the organization, a conflict of interests arises. Directors have a duty to report the conflict of interest and take action to avoid using their position on the

board to serve their personal interests.

For example, directors would be in a conflict of interest if they:

- sold personal services or skills to the board of directors or the organization (such as computer services to set up a system for the organization)
- used the organization's funds for personal purposes (such as taking their own clients or families to dinner, or charging the organization for taxi rides used for personal business)
- obtained a mortgage or loan for themselves, or a friend or family member, or
- stole the business opportunities of the organization (such as taking membership lists and using them for personal business).

A conflict may also arise when a person is a director of two organizations involved in the same transaction; the conflict occurs because the director owes a fiduciary duty to both organizations.

There is nothing inherently wrong with having a conflict of interest, or even from making a personal profit by providing goods or services to the organization. The problem is when a director fails to put the interests of the organization first. Therefore, a prudent director who faces a conflict of interest will immediately report the conflict to the board and take action to avoid using their position on the board to serve their personal interests.

In reporting the conflict of interest to the board, the director's disclosure must:

- be full and honest
- be made promptly to each director
- include the specific form of the interest, and
- include the benefit that would be received.

For example, a nonprofit organization can buy property from a company owned or directed by one of its board

members. Because the director can personally profit from the transaction, she is in a conflict of interest position. She has a duty to tell the board of her conflict of interest and then not vote on the issue or be counted as part of the quorum.

Failure to disclose and take measures to avoid a conflict of interest may result in a director being required to repay any profits he or she made or any losses suffered by the organization.

A detailed example of a conflict of interest is provided next.

*case study -
Conflict
of interest
at heritage
site*

A director on the board of a heritage village organization personally donated land for the village and also provided start-up money through mortgages to the organization.

After several successful years, the organization developed financial problems because it was no longer able to obtain funding from the federal government. The director negotiated a deal with the provincial government to have it buy the village and operate it as a heritage site. Part of the deal was that she would receive a sum of money from the sale to pay out the mortgages she held against the organization.

When the board met to discuss the sale, the director informed them that she would receive a cash settlement from the sale and then did not vote.

Three other directors who were absent from this board meeting sued her for breach of fiduciary duty and asked the court to declare the sale invalid and have her return the money she was paid. The judge dismissed the lawsuit against the director because she had disclosed her interest and the money she received from the sale compensated her for legitimate debts owing to her by the organization.

If the director had received the money as a commission for arranging the sale, however, the result would probably have been different. She would then have used her position as a director to make a personal profit, and the court might have ruled that she had breached her fiduciary duty. The director would then have been ordered by the court to pay to the organization the money she had received as a commission.

Duty to not engage in criminal activities

If an organization commits any criminal activity, the directors may also be guilty of the same offence. For example, an organization can be convicted of fraud for juggling the accounts to avoid paying creditors, destroying or falsifying documents, or failing to keep proper particular financial accounts.

A director who suspects that an activity of an organization or the board of directors may be illegal should make their objection known, and have the objection recorded in writing in the minutes. Directors may wish to seek legal advice regarding the possibility of any criminal activities.

Duty to maintain the organization's legal status

Once an organization is incorporated, there are a number of things it must do each year to maintain its incorporated status. If they are not done, the government may cancel the organization's registration, which has the effect of unincorporating it.

As outlined in [Chapter 3](#), a nonprofit organization that operates in British Columbia can incorporate either provincially, under B.C.'s Society Act, or federally under Part II of the Canada Corporations Act. Some of the duties listed in these two statutes include the responsibility to:

- keep an up-to-date list of all members (which may also include addresses, occupations, class of membership, membership expiry dates and a list of former members)
- maintain bank accounts and banking records
- keep financial records, including the amount and source of all income and every expenditure, the assets and liabilities of the society, and any other transaction that affects the financial position of the society
- hold annual general meetings (AGMs) and file an annual statement and report with the Registrar of Companies
- present information to members at AGMs, including directors' reports, financial statements and an auditor's report
- hold a special general meeting on request of the members

- make changes to the constitution or bylaws, as necessary, and file the information with the appropriate registrar, and
- keep minutes of directors and members meetings.

Again, these are just some of the duties listed under B.C.'s Society Act and the Canada Corporations Act. Directors should consult a copy of the appropriate statute to ensure that these and other obligations are properly met.

Failure to follow requirements of these statutes may lead to personal liability of directors, fines and, in some cases, imprisonment. Directors may also find themselves personally liable for failing to meet requirements under other statutes, such as the Income Tax Act. It is the responsibility of the board of directors to ensure that these requirements are met, even if the organization has delegated the task to employees or outside parties, such as accountants.

statutory duties - Duties of charitable organizations

Legal obligations may arise if an organization is registered as a charity under the federal Income Tax Act. Charitable status is limited to those organizations that meet criteria as to their purposes and activities. Duties under the act are quite strict.

For example, there are clear guidelines and responsibilities when tax receipts are issued to donors. Organizations can find themselves in serious difficulties with Revenue Canada if they issue large income tax receipts to donors without fully understanding the implications of issuing the receipt.

Also, an organization's charitable status should be considered before its constitution is altered to reflect a change in the organization's direction or activities. A tax specialist may need to be consulted.

Directors should obtain a copy of relevant statutes

Directors should make sure they read all statutes related to the activities of the organization, including the statutes under which the organization is incorporated.

Here are just a few examples of B.C. statutes that directors may wish to obtain:

- the Society Act, which sets out the roles and responsibilities of nonprofit organizations and boards

- the Employment Standards Act, which sets out who is considered to be an employee and how they must be treated
- the Cooperative Association Act, which includes housing cooperatives
- the Food Donor Encouragement Act, which sets out how food can be collected and redistributed through charitable programs, or
- the Child, Family and Community Service Act, which sets out services provided to children and families, including things like reporting suspected abuse, and protecting children's privacy.

Contact information for provincial government offices is provided in the [Introduction](#) to Volunteers & the Law.

Duty to employees

Boards of directors have a duty to ensure that the organization meets its responsibilities as an employer. Employer responsibilities are set out in many federal and provincial statutes – such as B.C.'s Employment Standards Act – and, where applicable, the employees' collective agreement.

For example, some employer duties include:

- duty to pay full wages, including overtime and vacation pay
- duty to provide paid days off for statutory holidays
- duty to make employee deductions (CPP, EI and Income Tax)
- duty to provide a safe workplace, and
- duty to protect employees from discrimination.

Directors should ensure that appropriate measures are made to comply with employer responsibilities – this duty cannot simply be delegated to administrators.

In some cases failure to meet statutory duties can result in penalties and fines, as well as risking the personal liability of individual directors.

In some cases, directors may also be held personally liable for the organization's failure to meet its obligations to employees. For example, if a board is having funding difficulties and decides to find a way to avoid paying wages owed for overtime, the employees may sue the organization and its board of directors. Similarly, an employee who has been mistreated or wrongfully dismissed may sue the organization and, in some situations, directors may be personally liable. If an organization becomes insolvent, directors may become personally liable for the unpaid wages of employees.

Finally, directors may also be personally liable if they act in a negligent manner toward an employee. For example, a director who personally interferes with an inquiry into workplace safety may be held personally liable.

Duty to act within scope of authority

A final caution for directors involves the importance of understanding the limits of their authority. Directors who act outside of their own scope of authority, or allow the organization to act outside of its permitted activities, may find themselves personally liable.

Consider, for example, two directors who obtain a bank loan to enable their organization to buy a van. If the loan does not have the formal approval of the board, or if the loan is made in the names of the directors and not in the name of the organization, the two directors who obtained the loan may be personally liable for its repayment.

If the purchase turns out to be a good idea and the other board members agree, the board can take over responsibility for the loan. However, in this case the two directors should not vote on the ratification of the loan, as doing so would likely be a conflict of interest.

In a similar way, directors may be personally liable if they allow the organization to act outside the scope of its permitted activities. Statutes governing nonprofits, such as B.C.'s Society Act, place requirements on organizations to act within the stated purpose of the organization.

It is not difficult for a voluntary organization to mistakenly move away from its legal purpose. Over time an organization's direction may change, but if the constitution is not formally changed to meet these new purposes, actions of directors may be outside of their authority. Directors may be personally liable for losses to the society, no matter how well-intentioned their decisions

may have been.

An example of the duty to act within scope of authority follows.

When missionary work becomes a summer camp

A church group was incorporated for the purpose of carrying on specific missionary work. One of the church members donated some land for a summer camp that over the years became highly successful. Gradually, the focus of the organization turned to the running of the camp, which became quite large and successful, generating considerable income.

The camp itself would have made an excellent charitable organization, but it was not within the purpose as stated by the organization's constitution. The directors, with the best of motives, had unintentionally gone outside of their authority as directors and would have been personally liable for any losses to the church group. For example, if a child had been badly injured by the negligence of a camp counsellor, the directors could become personally liable.

The risk is even greater because insurance contracts often state that claims are only insured if they arise from the lawful activities of the organization. Most directors would have thought the camp was a lawful activity, but because it did not conform to the lawful purposes of the organization, the insurance company could refuse to pay the claim. Without insurance coverage, the directors would be personally liable.

If the organization changed its constitution to reflect the purpose of the summer camp, the directors would once again be acting within their authority and would not be risking personal liability.

Prevention checklists for boards and directors

Before you become a director

- Learn about the organization's goals, objectives and programs.
- Enquire about the community and professional image of the organization.

Know your legal liability and duties

- Gather as much information about the organization as possible, including policies, finances and staff.
- Read and understand the constitution and bylaws.
- Know the legal liability of the board and your personal liability as a director. Understand the limits of indemnification and insurance.
- Know your legal duties. Those introduced in this book include:
 - Fiduciary duties, including:
 - duty to perform with diligence, care and skill
 - duty to act with prudence
 - duty to avoid a conflict of interest
 - Duty to maintain the organization's legal status
 - Duty to employees, and
 - Duty to act within scope of authority.
- Ensure the board has appropriate policies, such as a policy about board liability or a conflict of interest policy.

Be an active participant

- Attend all meetings of the board, or as many as possible.
- Read minutes and reports in advance of meetings.
- Promptly complete any tasks you agreed to do.
- Make inquiries about the management and operation of the organization when necessary.
- Insist that all committee meetings are reported at board meetings, either in oral or written form.
- Obtain and read copies of minutes for any meetings you miss.
- If you disagree with decisions made in your absence, have your dissent recorded at the next meeting.
- Keep a copy of all minutes and other important documents.
- Ask questions until you are sure you understand a board decision.

Take care when voting

- Fully understand an issue and its consequences before voting on it.
- Vote against spending money or incurring debts if you believe the organization will not be able to pay.

Be loyal to the organization

- If you dissent to a motion, be sure it is recorded in the minutes.
- If necessary, keep your own notes.
- Always put the interests of the organization before your own.
- Don't gain personal advantage from your position.
- Avoid and disclose all conflicts of interest.

Act prudently

- Don't allow the organization to take unreasonable risks.
- Be certain that the organization's records are audited by a reputable firm of chartered accountants.
- Be certain that the organization will be able to pay for expenses it incurs or money it borrows.
- Obtain outside expert advice when necessary – for example, lawyers, engineers or accountants. If acting on it, get it recorded or submitted in writing.
- Review the CEO's performance and board's performance periodically.
- Do not act illegally or let staff act illegally.

Protect the organization's legal status

- Read the statute under which the organization is incorporated.
- Ensure the organization fulfils all aspects of its nonprofit and tax exempt status.
- Ensure legal obligations delegated to staff are completed.

For example:

- membership lists are up to date
- bank accounts and records are maintained
- annual general meetings are held and obligations met, and that a report is filed
- special general meetings are held if requested by the members
- constitution and bylaws are up-to-date, and changes are filed

Meet duties as an

- Be clear that the board has overall responsibility for employment practices of the organization.
- Ensure that employment policies are in place and reviewed periodically, particularly termination

employer

policies.

- Insist that there is a well-established personnel program with a competent person in charge of staff.
- Be sure that payroll deductions for income tax, EI and CPP are being made and remitted.
- Be sure that self-employed contract workers would not be considered employees under Revenue Canada guidelines.

Act within your scope of authority

- Do not act on the board's behalf without prior approval.
- Avoid obligations made in your own name.
- Ensure that the organization and board's activities are within the scope of their mandates.

Check insurance coverage

- Ensure that appropriate insurance covering all activities is obtained and maintained.
- Consider board insurance.

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You should not rely on this document for legal advice. It provides general information only.

We again thank the individuals and organizations who assisted in the publication of the original book, and its adaptation to the form it has on this website. Their names and work on this document are described in greater detail in the Introductory portion of Volunteers and the Law.

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The complete document consists of an Introduction along with five separate chapters

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Published Spring, 2000