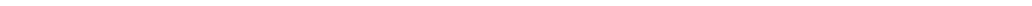


# **BOARD GOVERNANCE FOR EARLY STAGE TECHNOLOGY COMPANIES**

**A manual and series of best practices for Directors and executives of technology start-ups  
and angel-financed companies**

**May, 2016**



## Table of Contents

• <b><u>1. Introduction</u></b>	4
<u>1.2 Links</u>	6
<u>1.3 Preamble</u>	7
• <b>2. Board Manual</b>	10
<u>2.0 Board Terms of Reference</u>	11
<u>2.1 Director Terms of Reference</u>	19
<u>2.2 Chair Terms of Reference</u>	22
<u>2.3 Audit Committee Terms of Reference</u>	25
<u>2.4 Compensation Committee Terms of Reference</u>	30
• <b>3. Best Practices</b>	31
<u>3.0 Board Composition</u>	32
<u>3.1 Time Commitment</u>	36
<u>3.2 Director Compensation</u>	37
<u>3.3 Director Investment</u>	38
<u>3.4 Board and Management Responsibilities</u>	40
<u>3.5 Splitting the Roles of Chairman and CEO</u>	43
<u>3.6 Relationship Between Chairman and CEO</u>	44
<u>3.6.1 What the CEO Should Expect from the Board</u>	46
<u>3.7 CEO Review Process</u>	47
<u>3.8 CEO Succession</u>	49
<u>3.9 Founder's Syndrome</u>	51
<u>3.10 Authorization Levels</u>	53
<u>3.11 Risk Assessment</u>	54
<u>3.12 Strategic Planning</u>	56
<u>3.13 Whistle Blowing</u>	57
<u>3.14 Advisory Committees</u>	58
<u>3.15 Holding Management to Account</u>	59
<u>3.16 Board Review</u>	61
<u>3.16.1 Directors Matrix of Skills</u>	64
<u>3.17 Governance Practices by Stage of Growth</u>	65
<u>3.17.1 Summary Chart of Governance Practices</u>	72
• <b>4. Board Meetings</b>	73
<u>4.0 Organizing a Board Meeting</u>	74
<u>4.1 Sample Board Agenda</u>	78
<u>4.2 Who Should Attend Board Meetings</u>	80
<u>4.3 Meetings of Independent Directors</u>	81
<u>4.4 Frequency of Board Meetings</u>	82
<u>4.5 Physical Presence or Teleconference</u>	83
<u>4.6 Philosophy of Board Meeting Minutes</u>	84
<u>4.6.1 Sample Board Meeting Minutes</u>	88

<a href="#">4.7</a>	<a href="#">CEO Report to the Board Template</a>	97
<a href="#">4.8</a>	<a href="#">Sample CFO Report to the Board</a>	101
<a href="#">4.9</a>	<a href="#">Sample General Report to the Board</a>	106
<a href="#">4.10</a>	<a href="#">Written Resolutions</a>	109
<a href="#">4.11</a>	<a href="#">Review of Resolutions by Legal Counsel</a>	111
<a href="#">4.12</a>	<a href="#">Role of the Corporate Secretary</a>	112
•	<b>5. Downloads</b>	115
	<a href="#">(online version)</a>	
•	<b>6. Written Articles</b>	116
<a href="#">6.1</a>	<a href="#">Boards are even more important for start-ups</a>	117
<a href="#">6.2</a>	<a href="#">What Should Boards of Early Tech Companies Do?</a>	118
<a href="#">6.3</a>	<a href="#">Directors Need to be on Common Ground</a>	119
<a href="#">6.4</a>	<a href="#">Managing Fiduciary Duty – Charting the Course</a>	121
<a href="#">6.5</a>	<a href="#">Steering the Ship of Fiduciary Duty in a Sea of Conflict</a>	123
<a href="#">6.6</a>	<a href="#">When Does Management Cross the Line?</a>	125
<a href="#">6.7</a>	<a href="#">Should I Stay or Should I Go?</a>	126
<a href="#">6.8</a>	<a href="#">Less Minutes Equals Less Mischief</a>	129
<a href="#">6.9</a>	<a href="#">You have my time – now you want my money too?</a>	131
<a href="#">6.10</a>	<a href="#">The Loneliness of the Corporate Secretary</a>	133
<a href="#">6.11</a>	<a href="#">Judges or Mentors – Directors Must Lead</a>	136
<a href="#">6.12</a>	<a href="#">Duty of the CFO – to the CEO or Board?</a>	138
<a href="#">6.13</a>	<a href="#">Governance Practices by Stage of Growth for Early Stage Technology Companies</a>	140
<a href="#">6.14</a>	<a href="#">Governance Practices at the Start-up and Angel Stages of Growth</a>	142
<a href="#">6.15</a>	<a href="#">Governance Practices at the Venture Growth Stage</a>	144
<a href="#">6.16</a>	<a href="#">How to Manouver a Successful Board Meeting</a>	147

## **Section 1.**

# **INTRODUCTION**

## 1.0 Introduction

### Welcome to [earlystagetechboards.com](http://earlystagetechboards.com) !

This website has been created to assist directors and managers of early-stage technology companies to develop and operate high performing Boards of Directors.

Boards of early stage technology companies have significant challenges: incomplete management teams, inexperienced and aggressive founders, lack of resources, high risk with small margins for error, etc. Experienced directors can make a significant difference if the Board is structured and empowered properly. The technology industry needs a system of Board governance that addresses its issues. Please see the [preamble](#).

This website includes dozens of documents prepared by experienced directors and advisors in the technology industry in Vancouver, B.C., Canada. The documents use material taken from sites available online which are included in the [links](#) section. It includes manuals which capture the responsibilities and requirements for Boards and Committees, several documents on best practices and practical advice on organizing Board meetings.

Please use the menu at the top of this page to get access to the various sections, or use the "prev" or "next" links on the left menu to go through the documents in sequence.

These documents are available for anyone to use. Please feel free to download and use at your convenience. We have included [links](#) to other relevant sites. We have provided a [Table of Contents](#) to make navigation a little easier.

We would appreciate learning from your experience. Please email me with your comments and suggestions. You can edit documents or write new ones. All good suggestions will be included, although I may exercise some editorial control.

Comments? Please email: [dwrowat@stratcat.com](mailto:dwrowat@stratcat.com) .

Strategic Catalysts Inc. is a private consulting practice operated by David W. Rowat in Vancouver, Canada. SCI provides strategic and financial advice to technology companies. Please visit the website at [www.stratcat.com](http://www.stratcat.com).

## 1.2 Links

\*\*\* [Comprehensive site on tech company board governance](#): Brad Feld, co-Founder of TechStars. His book: `Start-Up Boards – Getting the Most Out of Your Board of Directors`, Wiley, 2014. Key reference and is quoted frequently on this site.

[Gerard Buckley, Jaguar Capital](#): Several excellent articles on early stage Board governance

[National Angel Capital Organization \(Canada\)](#)

[Angel Capital Association \(US\)](#)

[Free Management Library](#)

[Angelblog on better performing boards](#)

[Levensohn articles on governance](#)

### **Canadian Associations Relating to Corporate Governance of Large Companies**

[Canadian Society of Corporate Secretaries \(CSCS\)](#)

[Institute of Chartered Secretaries and Administrators \(ICSA\)](#)

[Institute of Corporate Directors \(ICD\)](#)

[Canadian Coalition for Good Governance \(CCGG\)](#)

### **Links to U.S. Corporate Governance**

[US Governance Links](#)

[Building your Board: A Corporate Governance Guide for Entrepreneurs << excellent material>>](#)

[National Association of Corporate Directors](#)

[A Director's Handbook: A Guide for Directors of Privately Held Companies](#)

[David Berkus](#)

## 1.3 Preamble

### 1.0 Introduction

These documents are designed for the Boards of Directors for start-up, angel-funded, and venture-capital funded technology companies. Recently, corporate governance issues and the roles of Boards of Directors have come under greater scrutiny. The success rate of early-stage companies is approximately 10 – 20%, (depending upon the definition of success). The technology industry has recently come to appreciate that a properly structured and functioning Board in these early-stage companies is critical to their success. Improving the effectiveness of Boards could significantly improve the success of companies.

### 2.0 Challenges Specific to Early Stage Tech Companies

There are several factors which challenge the success of early stage tech companies:

2.1 Inexperienced management. Many tech companies are founded by entrepreneurs in their 20s and 30s. Many are looking to exploit a technical innovation they have developed or envision. Some see a market opportunity needing a new technology to fill. Typically, these entrepreneurs lack experience in the many facets of growing a successful technology company: planning, budgeting, human resources, finance, sales, marketing, governance, risk management, etc.

2.2 Under capitalized. Most technology companies, particularly in Canada, do not have anywhere near enough capital to hire the experienced senior executives they require, or to invest in sales and marketing, where the battles for markets are won and lost.

Consequently, many founders perform many functions in the absence of an experienced team around them. They are stretched too thin and are performing many tasks for which they are not trained, and worse, ill-suited.

2.3 Rapid change. The technology industry moves quickly. Opportunities present themselves quickly and unforeseen problems can spring up. Decisions must be made quickly often without all of the information required. Inexperienced management teams often make the wrong decisions.

2.4 Large consequences and small margin for error. Often, an opportunity or a problem can have significant impacts, positive or negative. Whereas larger, more mature companies can diversify their risks, early stage companies are often confronted with a single, "bet the company" decision. Because the companies are small, the margin for error in the decision is also small. Experienced advice is crucial in improving decision-making.

2.5 Hubris. Also called "Founder's Syndrome", technology entrepreneurs are typically high-energy, confident people, or else they never would have taken the risk to found a company. While this strength of character is essential to driving the Company through the many challenges to success, it has a dark side. Many entrepreneurs believe they have all

the answers and resist advice. They also want to make all the important decisions themselves, and frequently over-rule decisions with which they do not agree. This behaviour typically prevents the company from growing larger than a small size defined by what can be accomplished by a single, driven founder. Usually it causes the company to become one of the 80-90% that fail to achieve their expectations. Worse, founders often realize that they need to take advice and delegate decisions, and resolve to do so. They hire senior executives and strengthen their Board. Often, they may cede the CEO position to an experienced manager. However, as well-intentioned as these actions are, when confronted by an important decision with which they do not agree, they may grab back the controls, cursing the day that they listened to people who didn't understand the situation. Please see related document [Founder's Syndrome](#).

These are a few of the problems that distinguish early stage technology companies from later-stage companies. Whereas mature companies typically have experienced management that can anticipate and mitigate problems which manifest themselves over time, and draw upon ample internal resources and the experience of a seasoned Board, early stage companies have few of these advantages.

### 3.0 Typical Boards are Ineffective

Typically, Boards of early-stage companies are not well-equipped to help. Frequently, there is no effective Board at all. At start-up, it may consist of the founders and perhaps a couple of senior executives. As they begin to raise financing from friends and family, one or more of these people might join the Board. However, none of these people are independent of the founders and cannot provide the detached oversight that the company needs. Few could challenge the founders if they believed they were acting in error. If the company grows and is able to attract angel or venture capital investment, the Board will gain strength from the appointment of angels who have operational experience or VCs who understand governance issues and provide oversight. However, stronger Board members do not always lead to a stronger Board. Too often, the directors are extremely busy, dividing their time among many investments. They cannot spend the time required to assist management in evaluating the information and exploring options, so their value is not realized. When faced with the determination of a mis-guided founder, many will defer, or resign; neither of which helps the company.

### 4.0 Improvements are Happening

Early-stage companies have a greater requirement for the oversight and advice that an experienced Board can provide, yet rarely is this present. Fortunately, informed by the growing expectations of Boards of large public companies as the implementation of the Sarbanes-Oxley proceeds, many technology industry veterans are now also focusing on the role of the Board in early-stage technology companies. In the context of the challenges described above, there is a consensus that these Boards need to be more proactive and to exert a greater level of oversight than has been the case up to now. The jobs of Directors, and particularly of Chairman, now require more time and effort.

## 5.0 Other Help Boards Can Provide

In addition to the oversight and mentoring of management which are the focus of this website, Boards can help early stage tech companies in other tangible ways:

- Networking and contacts to accelerate business development, financing and recruitment.
- Credibility that comes with the active support and involvement of respected industry veterans.
- Strategic thinking to inform the company direction in the longer range, and its eventual exit.

## 6.0 Closing Thoughts

I have assembled this compendium of documents to assist entrepreneurs, directors and companies to structure and operate a Board of Directors. These Boards will be proactive and operate at a much higher level of governance than has been typical to date. The goal is to improve the performance of the Board, in order to improve the performance of the companies and their management teams, and to increase the success rate of early stage technology companies.

Although these materials may be useful to directors and managers in many jurisdictions, they are written on the basis of Canadian law and practice.

<sup>1</sup> For more information on the stages of company growth, please see the seminal article: "Evolution and Revolution as Corporations Grow", Larry Greiner, Harvard Business School press, <http://harvardbusinessonline.hbsp.harvard.edu/relay.jhtml?name=itemdetail&id=98308>.

## **Section 2**

# **BOARD MANUAL FOR EARLY STAGE TECHNOLOGY COMPANIES**

This Section describes the structure of the Board and its terms of reference, and similarly for Directors and Board Committees

## 2.0 Board Terms of Reference

### 1 PURPOSE<sup>1</sup>

- 1.1 The Board has the primary responsibility to oversee the conduct of the Company and to supervise management, which is responsible for the day-to-day activities. In performing its functions, the Board primarily considers the interests of the Company to which its fiduciary duty ultimately resides, and then to its shareholders. It also considers the legitimate interests of other constituents such as employees, suppliers, and customers.
- 1.2 In early stage technology companies, the Board is more proactive in advising management on a range of operational issues, and holding management accountable for management's decisions, actions, or lack of action. That said, however, the Board does not overturn management decisions, nor substitute its judgment for the judgment of management. It does not make operational decisions in lieu of management. To do so would usurp management's proper role and involve the Board too deeply, both of which would be improper. Please see related document [Board and Management Responsibilities](#). The Board can and should probe management's analysis of the facts and decision-making process to ensure that it has considered all of the material facts and outcomes of its decisions. The Board can and should withhold approval of management's decisions and recommendations if the analysis is weak or does not support the decisions and recommendations, and request management to return with improved decisions and recommendations.
- 1.3 The Board must ensure that it has all of the material information available which it must consider in making a decision or approving management's decisions. Management must provide full (but concise), plain, true and timely information to the Board. The Board is reasonably entitled to seek outside advice, such as from corporate counsel, with or without management's approval, in the exercise of its fiduciary duties, and at the Company's expense.
- 1.4 The directors are stewards of the Company. The Board acts on behalf of the shareholders and is accountable to the shareholders for the conduct of the Board, management and the Company.
- 1.5 In supervising the conduct of Company, the Board, through the Chief Executive Officer ("CEO"), will set the standards of conduct for the Company.
- 1.6 These terms of reference are prepared to assist the Board and management in clarifying responsibilities and ensuring effective communication between the Board and management.

## 2 COMPOSITION AND BOARD ORGANIZATION

- 2.1 The number and composition of the Board depends upon the state of development of the early-stage technology company; typically three or five, of which the majority should be independent directors. Please see related document [Board Composition](#).
- 2.2 The Board Chair shall be appointed by the Board for a term expiring at the conclusion of the next Annual General Meeting of the Company.
- 2.3 Directors will be elected at the Annual General Meeting of the Company and will serve until the conclusion of the next Annual General Meeting of the Company.
- 2.4 A vote by three-quarters of the Board, not including the Director in question, will be sufficient to remove a Director.
- 2.5 The Board operates by delegating to management certain of its authorities, including spending authorizations, and by reserving certain powers to itself.
- 2.6 Certain responsibilities of the Board may be delegated to Board committees. The responsibilities of those committees will be as set forth in their terms of reference, as amended from time to time.
- 2.6.1 Compensation and Human Resources Committee, whose responsibilities will include many of the items articulated in Section 3.2. Please see related document [Compensation Committee Terms of Reference](#).
- 2.6.2 Audit Committee, whose responsibilities will include many of the items articulated in Section 3.3. Please see related document [Audit Committee Terms of Reference](#).
- 2.6.3 At a time when it is deemed appropriate by the Board in consultation with management, the Board will constitute a Governance Committee whose responsibilities will include many of the items articulated in Section 3.4.
- 2.7 The Board retains the responsibility for managing its own affairs including the responsibility to:
- i) Appoint the Chairman of the Board;
  - ii) Appoint, review and/or replace the Chief Executive Officer. Please see [CEO Review Process](#) and [CEO Succession](#);
  - iii) determine the frequency, timing and agenda for Board meetings. Please see related document [Frequency of Board meetings](#);
  - iv) annually review the skills and experience represented on the Board in light of rapidly changing business requirements. Please see related document [Board Composition](#);

- v) recommend the criteria and potential candidates who meet the criteria to the Board. Please see related document [Board Review](#);
- vi) on the recommendation of the Chair, appoint, determine the composition of and set the terms of reference for Board committees;
- vii) approve the terms of reference for the CEO and Chairman. Please see related document. Please see related documents [Chair Terms of Reference](#) and [Board and Management Responsibilities](#);
- viii) implement an appropriate process for assessing the effectiveness of the Board, the Board Chair, committees and directors in fulfilling their responsibilities. Please see related document [Board Review](#);
- ix) assess the adequacy and form of director compensation and make recommendations to the shareholders to approve the director compensation at the Annual General Meeting. Please see related document [Director Compensation](#);
- x) assume responsibility for Company's governance practices and ensure they meet the needs of the shareholders, employees and customers; and
- xi) appoint the Secretary to the Board.

### 3. DUTIES AND RESPONSIBILITIES

#### 3.1 Company Plans

The Board has the responsibility to:

- i) participate with management in the development and approval of the Company's annual Operating Plan and Budget. Please see related document [Board and Management Responsibilities](#);
- ii) approve other material plans that support the Company's ability to meet its Operating Plan;
- iii) direct management to develop, implement and maintain a reporting system to allow the Board to monitor the Company's progress towards the goals of the Operating Plan;
- iv) investigate major deficiencies in performance and major deviations from the Operating Plan and requests management to explain reasons and to develop and implement corrective action; and
- v) review and approve significant changes to the Operating Plan in light of changing business circumstances. Please see related document [Board and Management Responsibilities](#)

#### 3.2 Compensation and Human Resources

The Board has the responsibility to:

- i) approve terms of reference for the CEO and appoint the CEO and plan for succession of the CEO, as required. Please see related document [CEO Succession](#);

- ii) monitor and, at least annually, review the CEO's performance against agreed upon annual objectives. Please see related document [CEO Review Process](#);
- iii) approve compensation plans for the CEO and senior management, including salary, cash incentive compensation and equity;
- iv) review and approve recommendations of the CEO with respect to the senior management structure, including such duties and responsibilities to be assigned to Officers of Company;
- v) on the recommendation of the CEO, appoint the Officers of Company who report to the CEO;
- vi) approve certain matters relating to all employees, including:
  - a) Company's broad compensation strategy and philosophy;
  - b) employee equity plans;
  - c) employee benefit programs; and
  - d) review and implement succession planning programs, as and when required according to the Board's discretion, including programs to train and develop management. Please see related document [CEO Review Process](#);

### 3.3 Financial and Risk Issues

The Board has the responsibility to:

- i) monitor operational and financial results;
- ii) approve annual financial statements;
- iii) approve the financial plan for the company as recommended by management and as approved by the Audit Committee;
- iv) appoint external auditors and approve auditors' fees at such time as audited financial statements are required by the Board or external investors;
- v) take reasonable steps to ensure the implementation and integrity of Company's internal control and management information systems appropriate to its current state of development;
- vi) review the risk profile of the company in light of changing business circumstances. See related document [Risk Assessment](#).
- vii) Please see related document [Audit Committee Terms of Reference](#);

### 3.4 Governance

3.4.1 The Board has the responsibility to:

- i) provide advice, counsel and support to the CEO in the execution of the CEO's duties. See related document [Relationship between Chairman and CEO](#);
- ii) provide advice and approve material decisions including the following:
  - all acquisitions, dispositions, mergers, etc.;
  - significant hiring decisions; and
  - changes in strategic direction;

- iii) With the approval of the Audit Committee, provide advice and give prior approval to material financial decisions including the following:
  - the company financing program and plans;
  - all term sheets proposing to raise financings;
  - all financings;
  - significant capital expenditures;
  - all issuances of securities;
  - investment policy;
  - declaration of dividends; and
  - approve the spending limits and materiality level for contracts which must be approved by the Board. Please see related documents [Board and Management Responsibilities](#), [Authorization Levels](#);
- iv) review and approve material contracts and expenditures;
- v) review and approve all proposals to be submitted to the shareholders for approval.

3.4.2 At the appropriate time, as determined by the Board in consultation with management, the Board should oversee:

- i) the adoption of a strategic planning process;
- ii) succession planning, including appointing, training and monitoring senior management; and
- iii) the adoption of a communications (investor relations) policy for the corporation.

### 3.5 Board Secretary

The role of the Secretary is to:

- i) in consultation with the CEO and Chairman, organize and publish the annual calendars for the Board and Committees;
- ii) prepare the Agenda for Board meetings in consultation with the Board Chair. See related document [Organizing a Board Meeting](#);
- iii) prepare briefing binders for each Board meeting containing written memos to the Board on each Agenda item and clearly indicating which items require Board approval;
- iv) circulate the briefing binders to the Board at least 5 business days in advance of the meeting;
- v) organize the Board meetings;
- vi) take the minutes of the Board meetings, and have them reviewed by the Board Chair as soon as possible after the conclusion of the meeting. See related document [Organizing a Board Meeting](#);
- vii) maintain the share capitalization table including all shares, options, and vesting details;
- viii) liaise with legal counsel; and
- ix) ensure that the Minute Book and Share Registry are up to date.

### 3.6 By-Laws, Policies and Procedures

The Board has the responsibility to:

- i) approve and act as the guardian of Company's corporate values, including approving a Code of Conduct and Conflict of Interest Guidelines for Company;
- ii) direct management to ensure Company operates at all times within applicable laws and regulations and to the highest ethical and moral standards; and
- iii) approve changes to the Articles and By-laws of the Company subject to shareholder approval.

## 4. GENERAL LEGAL OBLIGATIONS OF THE BOARD OF DIRECTORS

- 4.1 The Board is responsible for directing management to ensure legal requirements have been met, and documents and records have been properly prepared, approved and maintained.
- 4.2 Legal duties are imposed on directors. The basic legal duties are imposed at common law.
- 4.3 Directors are under a fiduciary duty to the Company to carry out the duties of their office:
  - i) honestly and in good faith;
  - ii) in the best interests of the Company;
  - iii) with the care, diligence, and skill of a reasonably prudent person; and
  - iv) with a view to the best interests of all of the shareholders.

Specifically, Directors are required to act not to advance their individual interests as investors and shareholders over the interests of all of the shareholders.

See related document [Director Terms of Reference](#).

- 4.4 In order to execute their fiduciary duty, Directors have an obligation to make themselves fully informed on the issues by:
  - i) reviewing the material presented by management; and
  - ii) asking questions of management both at and between Board meetings to ensure that:
    - a) the Board receives adequate and regular updates from management on all issues important to the business of Company; and
    - b) major Company initiatives have proper and timely Board understanding, consideration, oversight and approval.

Please see related document [Holding Management to Account](#).

- 4.5 The CEO will pro-actively ensure the co-operation of the management team in assisting the Board in exercising its fiduciary duty in particular ensuring that the Board:

- i) has received all of the relevant information it needs to an appropriate level of detail;
- ii) is aware of relevant trends;
- iii) is aware of any material internal or external changes;
- iv) is informed of any actions or omissions which may cause the Company to be in violation of previous Board decisions, or the Code of Conduct of the Company, or its duties to shareholders, employees, partners and the public, broadly defined; and
- v) is aware of any changes in the assumptions upon which previous Board decisions were made.

4.6 Directors have specific statutory duties and obligations (and potentially personal liability) set out in legislation including:

- i) Provincial
  - a) Corporations Act
  - b) Environmental Management Act
  - c) Employment Standards Act
  - d) Social Services Tax Act
  - e) Workers Compensation Act
- ii) Federal
  - a) Excise Tax Act
  - b) Income Tax Act
  - c) Employment Insurance Act
  - d) Criminal Code of Canada (Conspiracy).

Please see related document [Risk Assessment](#).

**TIMETABLE**

	Q1	Q2	Q3	Q4
<b>1. Governance</b>				
Review Board skill sets wrt current company requirements		✓		✓
Identify prospective new directors				✓
Prepare slate of Directors for AGM	✓			
Review Board performance and compensation	✓			
Annual General Meeting		✓		
Approve Annual Report		✓		
Ensure Minute Book, Share Register, Articles and By-Laws are up to date			✓	
Review strategic plan			✓	

<b>2. Financial</b>				
Receive report of Audit Committee	✓			
Approve audited financial statements	✓			
<b>3. Compensation</b>				
Receive report of Compensation Committee		✓		
Review CEO performance		✓		
<b>4. Operations</b>				
Approve annual Operating Plan and Budget	✓			
Review performance against annual Operating Plan and Budget	✓	✓	✓	✓

<sup>1</sup> These documents are developed specifically for Boards and management of early stage technology companies. See [Preamble](#) for the context in which these documents were developed.

## 2.1 Director Terms of Reference

### 1. INTRODUCTION

The Board of Directors acts collectively and exercises its powers and responsibilities as a group. Individual directors have no power to act on their own, other than to ensure that they have access to all of the information required to exercise their duties. Please see related document [Board Terms of Reference](#).

### 2. FIDUCIARY RESPONSIBILITIES

Broadly speaking, a director of the Company has several fundamental obligations to perform.

### 3. HONESTY AND GOOD FAITH

Common law and the Corporations Act require a director to act honestly and in good faith with a view towards the best interests of the Company. The key elements of this standard of behaviour are:

- i) A director must act with a view to the best interests of the Company and not in his or her self-interest. This also means a director must not act in the best interests of some special interest group or constituency.
- ii) A director cannot take personal advantage of opportunities that come before him/her in the course of performing his/her director duties.
- iii) A director must disclose to the Board any personal interests that he/she holds that may conflict with the interests of the Company.
- iv) A director must respect the confidentiality requirements of the Company's Code of Conduct and Conflict of Interest Guidelines.

#### 3.1 Skillful Management

A director shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in similar circumstances. This means:

- i) The standard of behavior expected of a director will depend upon the particular qualities or characteristics that the director brings to the Company relative to the particular matters under consideration.
- ii) The director must be proactive in the performance of his or her duties by:
  - a) attending Board and committee meetings; a director who has not attended meetings, must show diligence by examination of reports, discussion with other directors, and otherwise being sufficiently familiar with the Company's activities so that none of the director, Board and company suffer as a result of non-attendance;

- b) making themselves fully informed on the issues by:
  - 1. reviewing the material presented by management; and
  - 2. asking questions of management both at and between Board meetings to ensure that:
    - i) the Board receives adequate and regular updates from management on all issues important to the business of Company; and
    - ii) major Company initiatives have proper and timely Board understanding, consideration, oversight and approval.
- c) participating in a meaningful way; and
- d) being vigilant to ensure the Company is being properly managed and is complying with laws affecting the Company.

See related document [Board Terms of Reference](#).

#### 4. STANDARDS OF BEHAVIOUR AND ACTIVITY ESTABLISHED BY THE BOARD

##### 4.1 General

As a member of the Board, each director will:

- i) demonstrate a solid understanding of the role, responsibilities and legal duties of a director;
- ii) demonstrate high ethical standards in personal and professional dealings; and
- iii) understand the difference between governing and managing, and not encroach on management's area of responsibility.

##### 4.2 Plans

As a member of the Board, each director will:

- i) contribute and add value to discussions regarding the company's goals and objectives; and
- ii) participate in monitoring and evaluating the success of the Company and the CEO in achieving established goals and objectives.

##### 4.3 Preparation, Attendance and Availability

As a member of the Board, each director will:

- i) prepare for Board and committee meetings by reading reports and background materials distributed in advance;
- ii) maintain an excellent Board and committee meeting attendance record<sup>1</sup>;
- iii) organize him/herself so as to be available to attend the entire Board or committee meeting, not just parts of meetings;
- iv) devote at least 5 – 15% of his working time to Board activities, depending upon the circumstances. See related document [Time Commitment](#); and

- v) participate in committees and contribute to their purpose.

#### 4.4 Communication and Interaction

As a member of the Board, each director will:

- i) demonstrate good judgment;
- ii) interact appropriately with the leadership and management of the Company;
- iii) participate fully and frankly in the deliberations and discussions of the Board;
- iv) be a positive and constructive force within the Board;
- v) demonstrate an openness to others' opinions and the willingness to listen;
- vi) have the confidence and will to make tough decisions, including the strength to challenge the majority view;
- vii) maintain collaborative and congenial relationships with colleagues on the Board;
- viii) advise the CEO and the Chair in advance when introducing significant and/or previously unknown information or material at a Board meeting; and
- ix) advise the CEO and the Chair in advance when the Director cannot fully support a recommendation to come before the Board.

#### 4.5 Company Knowledge

Recognizing that good decisions can only be made by well-informed directors, each director will:

- i) become generally knowledgeable about the business of the Company and its industry;
- ii) participate in director orientation and development programs developed by the Company from time to time;
- iii) maintain an understanding of the regulatory, legislative, social and political environments within which the Company operates; and
- iv) become acquainted with the Company's senior management team;

#### 4.6 Company Support

Each director will support the Company by:

- i) becoming an effective ambassador and representative of the Company;
- ii) making introductions for the Company and management to individuals and entities which may further the business of the Company;
- iii) assisting in financing the Company;
- iv) making a personal investment in the capital of the company in a meaningful amount;
- v) undertaking other initiatives as recommended by the Board.

<sup>1</sup> The target is 100% attendance. Anything less than 80%, without extenuating circumstances, would create difficulties for the Board.

## 2.2 Chair Terms of Reference

### 1. INTRODUCTION

- 1.1 The Board Chair is appointed by the Board. See related document [Splitting the Roles of Chairman and CEO](#).
- 1.2 The Board Chair's primary roles are to:
- i) act as the presiding director at Board meetings; and
  - ii) manage the affairs of the Board of Directors including:
    - a) ensuring the Board is organized properly functions effectively and meets its obligations and responsibilities; and
    - b) that the appropriate committees are set up and that they are functioning and reporting to the Board; and
    - c) that the Board is able to function independently of management.
  - iii) act as the conduit between management and the remaining members of the Board,
  - iv) ensure that management is reporting properly to the Board, and
  - v) ensure that the other outside Directors are contributing.
- 1.3 The Board Chair is an ex-officio member of committees where he/she is not appointed as a full member.
- 1.4 The Board Chair works closely with the Corporate Secretary and CEO, as required. Please see related documents [Organizing a Board Meeting](#) and [Relationship between Chairman and CEO](#).

### 2. DUTIES AND RESPONSIBILITIES

#### 2.1 Working with Management

The Board Chair has the responsibility to:

- i) act as a sounding board, counselor and confidant for the CEO, including helping to review plans, define issues, maintain accountability, build relationships, and otherwise support the CEO. Please see related document [Relationship between Chairman and CEO](#);
- ii) represent the best interests of the Company in formal and casual interactions;
- iii) ensure the CEO is aware of concerns of the shareholders;
- iv) lead the Board in monitoring and evaluating the performance of the CEO. Please see related document [CEO Review Process](#);

- v) work closely with the CEO to ensure management plans and performance are appropriately represented to the Board. See related document [Board Terms of Reference](#); and
- vi) ensure compliance with the governance policies of the Board.

## 2.2 Managing the Board

The Board Chair has the responsibility to:

- i) chair Board meetings, ensuring that order is maintained and judiciously balancing the need for fairness and full information in addressing issues and the need to respect the time of Directors and management;
- ii) with the CEO, ensure that the appropriate issues are addressed at and between Board meetings;
- iii) chair regular meetings of independent Directors without management present. Please see related document [Meetings of Independent Directors](#);
- iv) establish the frequency of Board meetings and review such frequency from time to time, as considered appropriate or as requested by the Board. Please see related document [Frequency of Board Meetings](#);
- v) recommend the committee members and committee Chair appointments to the Board for approval. Please see related document [Board composition](#);
- vi) ensure the co-ordination of the agenda, information packages and related events for Board meetings in conjunction with the CEO and the Corporate Secretary. Please see related document [Organizing a Board Meeting](#);
- vii) ensure with the CEO that major Company initiatives have proper and timely Board understanding, consideration, oversight and approval;
- viii) ensure the Board receives adequate and regular updates from the CEO on all issues important to the business of the Company. Please see related document [Director Terms of Reference](#);
- ix) build consensus and develop teamwork within the Board;
- x) review director conflict of interest issues as they arise;
- xi) in collaboration with the CEO, ensure information requested by directors or committees of the Board is provided and meets their needs;
- xii) review and assess director attendance and performance and the size and composition of the Board and make recommendations to the entities responsible for appointing directors as required. Please see related document [Board Review](#); and
- xiii) act as the primary spokesperson for the Board.

## 3. Devotion of Time

The Board Chair is expected to devote 15 – 25% of this working time to Board activities. Please see related document [Time Commitment](#).

#### 4. What Makes a Good Board Chair?

First, a good Board Chair must be pro-active. An inexperienced management team may overlook important issues, or not appreciate that certain issues require Board review and approval. The Chair must engage continuously with the CEO to obtain an appreciation of upcoming events which will help the Chair anticipate looming issues for the Board to address. The Chair must be work with the CEO and Secretary (if there is one) to ensure that the important items are on Board agenda. The Chair and the CEO must communicate with the other Directors between Board meetings to advise them of events, and seek their advice. A pro-active Chair helps the CEO to avoid surprises at the Board.

The Chair must also ensure alignment of the directors and management. Communication between meetings is essential to keep all directors in the loop. This minimizes the amount of precious time at the Board spent in bringing Directors up to speed and keeping them to the Agenda. As noted in Section 4, a Board package circulated in advance helps to bring the Directors up to speed and identifies any disagreements which may be mollified prior to the meeting.

In managing the Board's review of rapidly-changing events within the company, the Chair must be an excellent communicator. Directors should be chosen for the expertise they bring to the discussion, and so it is important that the Chair ensure that they get their share of the airtime. Too often, the loudest and most assertive voices and inhibit or drown out important input.

The Chair also must be decisive to ensure that issues are brought to a head and resolved within the constraints of the Board meeting. An iron hand inside a velvet glove may be required to bring all the opinions to the table, reach consensus and complete the agenda on time.

Finally, as noted in sections 3.6 – 3.8, the Chair must lead in advising the CEO and instigate the formal review process. It is a complex task to be both a mentor and a judge.

## 2.3 Audit Committee Terms of Reference

### 1. PURPOSE

1.1 The primary audit function of the Audit Committee (the "Committee") is to assist the Board in fulfilling its oversight responsibilities by reviewing:

- i) the financial plan for the Company;
- ii) the financial information that will be provided to the shareholders;
- iii) the systems of internal controls that management and the Board have established;
- iv) all audit processes;
- v) compliance with laws, regulations and policies that may apply; and
- vi) areas of significant risk and management's mitigation plan.

1.2 Primary responsibility for the financial reporting, information systems, risk management and internal controls of the Company is vested in management and is overseen by the Board.

### 2. COMPOSITION AND OPERATIONS

2.1 The Committee shall be composed of not fewer than three directors.

2.2 All Committee members shall be financially literate.<sup>1</sup>

2.3 The Company's auditors shall be advised of the names of the committee members and will receive notice of and be invited to attend Committee meetings, and to be heard at those meetings on matters relating to the auditor's duties.

2.4. The Committee shall meet with the external auditors as it deems appropriate to consider any matter that the Committee or the auditors determine should be brought to the attention of the Board.

2.5 The Committee shall meet at least once per year, and at the call of the Chair. (Audit Committees at some companies meet quarterly to review the financial performance of the company in depth to provide a summary report to the Board.)

2.6 The Committee has access to the Company's senior management and documents as required to fulfill its responsibilities and is provided with the resources necessary to carry out its responsibilities.

2.7 The CEO and CFO will ensure full support of the Company for the Committee's activities.

### 3. DUTIES AND RESPONSIBILITIES

Subject to the powers and duties of the Board, the Committee will perform the following duties:

#### 3.1 Financial Statements and other Financial Information

- i) The Committee will review and recommend for approval to the Board financial information that will be made available to shareholders. This includes:
  - a) review and approve the Company's annual audited financial statements and report to the Board before the statements are approved by the Board; and
  - b) review and recommend for approval of audited financial statements annually.
- ii) The Committee will review and discuss:
  - a) the appropriateness of accounting policies and financial reporting practices;
  - b) any significant proposed changes in financial reporting and accounting policies and practices to be adopted by the Company;
  - c) any new or pending developments in accounting and reporting standards that may affect the Company; and
  - d) management's key estimates and judgments that may be material to financial reporting.

#### 3.2 Internal Control and Information Systems

The Committee will review and obtain reasonable assurance that the internal control and information systems are operating effectively to produce accurate, appropriate and timely management and financial information. This includes:

- i) obtain reasonable assurance that the information systems are reliable and the systems of internal controls are properly designed and effectively implemented through discussions with and reports from management and the external auditor;
- ii) review management's steps to implement and maintain appropriate internal control procedures including a review of significant financial policies;
- iii) review adequacy of security of information, information systems and recovery plans;
- iv) monitor compliance with statutory obligations; and
- v) review the adequacy of accounting and finance resources.

#### 3.3 Risk

The Committee will review Management's assessment of the material risks confronting the Company and their plan for mitigation. See related document [Risk Assessment](#).

### 3.4 External Audit

The external auditor is ultimately responsible to the Committee and the Board of Directors as representatives of the shareholders. If the Board has approved the performance of an external audit, the Committee will review the planning and results of external audit activities and the ongoing relationship with the external auditor. This includes:

- i) review and recommend to the Board the engagement of the external auditor;
- ii) review the annual external audit plan, including but not limited to the following:
  - a) engagement letter;
  - b) objectives and scope of the external audit work;
  - c) changes in independent accounting and auditing standards;
  - d) materiality limit;
  - e) areas of audit risk;
  - f) staffing;
  - g) timetable; and
  - h) proposed fees;
- iii) meet with the external auditor to discuss the Company's annual financial statements and the auditor's report including the appropriateness of accounting policies and underlying estimates;
- iv) the auditor's evaluation of the Company's system of internal controls, procedures and documentation;
- v) the management letter containing any material findings or recommendation of the external auditor, including management's response thereto and the subsequent follow-up to any identified internal control weaknesses;
- vi) any other matters the external auditor brings to the Committee's attention;
- vii) assess the performance and consider the annual appointment of external auditors for recommendation to the Board;
- viii) review the non-audit services to be provided by the external auditor's firm or its affiliates (including estimated fees), and consider the impact on the independence of the external audit; and
- ix) meet periodically, and at least annually, with the external auditor without management present.

### 3.5 Other

- i) review material litigation and its impact on financial reporting;
- ii) meet as required with the Company's General Counsel to review outstanding legal issues relating to the Company;
- iii) retain the opportunity to undertake exit interviews with senior financial staff;
- iv) review expenses of the Board Chair and Company Officers annually; and
- v) review the terms of reference for the Committee annually and make recommendations to the Board as required.

4. ACCOUNTABILITY

The Committee shall report its discussions to the Board by oral or written report at the next Board meeting.

5. TIMETABLE

	Q1	Q2	Q3	Q4
<b>3.1 Financial Statements and other Financial Information</b>				
1. review and recommend:				
a) annual audited financial statements	✓			
b) review and recommend approval of content of Annual Report		✓		
c) review and discuss current accounting policies and financial reporting practices				✓
2. review and discuss management's key estimates and judgments that may be material to the financial reporting.				✓
<b>3.2 – 3.3 Risk Management, Internal Control and Information Systems</b>				
4. review company risks and mitigation strategies		✓		
5. review internal control systems	✓			
6. review adequacy of accounting and finance resources.	✓			
<b>3.4 External Audit</b>				
1. review & recommend engagement of external auditor			✓	
2. review external audit plan				✓
3. meet with auditor to discuss:				
a) annual financial statements	✓			
b) auditor's report	✓			
4. review planning, conduct & reporting of annual audit and advise Board	✓			
5. review auditor's evaluation of internal controls, procedures and documentation		✓		

6. review post audit or management letter and management's response		✓		
7. assess external auditor performance and make recommendation to Board		✓		
8. meet with the external auditor without management present.	✓			
<b>3.5 Other</b>				
i) review insurance coverage of significant business risks and uncertainties		✓		
ii) review material litigation and its impact on financial reporting	✓			
iii) review complaint procedures				✓
iv) review policies and procedures for review and approval of officers' expenses and perquisites				✓
v) review expenses of Board Chair and CEO	✓	✓	✓	✓
vi) review Committee terms of reference and make recommendations to the Board.		✓		

<sup>1</sup> "financial literacy" is the ability to read and understand a balance sheet, income statement and a cash flow statement in accordance with Canadian GAAP. "Accounting or financial experience" means the director shall have the ability to analyze and understand a full set of financial statements, including the notes attached thereto in accordance with Canadian GAAP.

## 2.4 Compensation Committee Terms of Reference

### 1. PURPOSE

The purpose of the Compensation Committee (the "Committee") is to assist the Board in fulfilling its obligations relating to compensation of the CEO and other Officers of the Company.

### 2. COMPOSITION AND OPERATIONS

The Committee will be composed of at least two, and preferably three, members; none of whom can also be members of Management.

### 3. DUTIES AND RESPONSIBILITIES

Subject to the powers and duties of the Board, the Committee will:

- i) Recommend a process to evaluate and appoint a Chief Executive Officer (the "CEO") and, when approved, lead the process in conjunction with the Board Chair. Please see related document [CEO Succession](#).
- ii) Recommend to the Board for approval the appointment of CEO and all other senior management positions that report directly to the CEO.
- iii) Annually review and recommend to the Board for approval the process for determining the compensation program for the CEO and Officers.
- iv) Annually review and recommend to the Board for approval the compensation program for the CEO and Officers.
- v) Annually review and recommend changes to the Committee's terms of reference.

### 4. ACCOUNTABILITY

The Committee shall report its discussions to the Board by oral or written report at the next Board meeting.

## **SECTION 3**

# **A SERIES OF BEST PRACTICES IN BOARD GOVERNANCE OF EARLY STAGE TECHNOLOGY COMPANIES**

### 3.0 Board Composition

1. Continuous evolution. The Board of Directors will evolve in size and composition from the start-up stage until the Company is fully operational. Directors must recognize that the composition of the Board must change over time. New directors may be appointed, and those that have completed their contribution may need to step aside. Typically, this is done on an annual basis leading up to the Annual General Meeting of the Company. Please see related documents [Board Review](#) and [Governance Practices by Stage of Growth for Early Stage Technology Companies](#).
2. Start-up. At start-up, the Board is usually comprised of the founders. As the Board's job is to protect the interest of the shareholders, which are the founders, this is appropriate. A typical Board size is three, although that may vary depending upon the number of founders. The Board often functions as a senior management meeting combined with a Board meeting. Decisions specific to Boards, such as share and options issuances, financings, etc. (see related document [Terms of Reference of a Board of Directors](#)) are decided at these meetings.
3. Friends and family funding. A start-up often raises funds from the founders, friends and family. Most of these early investors trust (and pray) that the founders know what they are doing, and are passive investors. They do not take a Board seat.

Occasionally, an experienced friend or family member will ask to sit on the Board to provide advice. This may or may not be a positive event. Typically, the new Board member is not sufficiently independent to provide objective advice and oversight for the founders. Also, their business expertise may not be applicable for the challenges of an early-stage technology company. The founders need to consider whether this new director is willing to step aside if new investors want a candidate with different strengths and experiences.

Again, the Board has typically three directors at this stage, but may expand to five, depending on the number of founders and active investors.

3.1 Fiduciary Duty. With external financing in place, the founders now have a fiduciary duty to investors other than themselves. This is a good time to begin to bring independence and oversight to the Board. The founders should begin to look for two or three independent directors who are experienced in one or more aspects of building start-up technology companies. The goal is to have a majority of independent directors on the Board. One or more of the founders may need to step off the Board. See section 6 below for guidelines on director appointments.

4. Angel funding. Angels are typically experienced technology executives who have been previously been CEOs or senior executives of technology companies. They invest in technologies and management teams that appeal to them. Some are passive investors, and some look for active involvement, usually with a Board seat. In any event, once an angel has committed to making an investment, he will look to see the Board become more independent and exercise objective oversight. More often, this is becoming a pre-condition for the angel to invest. If the angel is not taking a Board seat, he will often request that the Board and founders adopt a Board development plan that sees the Board comprised of a majority of independent directors,

each recruited for specific talents or experiences which can assist the company. Please see related document [Board Review](#).

It is at this point that a properly constituted Board with clear terms of reference can begin to be effective, as described in all of the accompanying documents.

5. Venture financing. As a requirement for financing, venture capitalists will formally restructure the Board of the Company. At this point, it is no longer a start-up. The entrepreneurial drive of the founders and senior management are now focused formally by the oversight of a professional Board. The VCs will typically take one or two seats on a Board of five directors, and look to have additional independent directors appointed. The founders will be limited to one seat, that reserved for the President and CEO.

Far too frequently, Boards of venture-backed companies do not perform well, even though the directors are usually experienced. There may be confusion about roles and responsibilities. Much of the material in this set of best practices is intended to influence the behaviour of Directors to improve the performance of the Board and the company.

#### 6. Recruiting Professional Directors.

The Board and management should develop a matrix of required skill sets and potential available candidates for director. Candidates can be evaluated based on their skills and experience and recruited to cover the important areas, particularly those in which the management team may be weak. See related document [Board Skills Matrix](#).

Recruiting independent professional directors can start any time. Likely, it will become a priority once Angels have invested, and will be an absolute requirement when Venture Capitalists invest. The earlier the company recruits Directors, the more likely they are to have ones which provide the skill sets and experience they need, rather than being subject to the appointees of investors, who may not have the same priorities.

Since the number of directors to be appointed is limited, the range of skills and experiences can be grouped into the following three categories, each of which should be represented on the Board:

- 6.1 Reputation Director: A reputation director is an independent which provides "name" recognition. This is someone with relevant industry experience according to the [Board Skills Matrix](#) developed for your company, and is well known in the community. He needs to be active in sourcing opportunities and opening doors. His presence provides Board validation and thus validation for the company. He often plays an instrumental role in introducing potential investors to the company.
- 6.2 Active Director: The Active Director is usually the Chairman of the Board. He drives the Board to ensure that it is functional and accountable. One of the huge failings of early-stage company Boards is that no one has the responsibility for ensuring that the Board executes its fiduciary duty. If the Directors are too busy, not close enough, and

not engaged, then they are not sufficiently informed or motivated to hold management accountable. Often, the Boards are then driven by the management and founders, particularly if they hold the majority of the equity. In this case, the Board may "look good" but is ineffective at its primary task.

It may well be the case that the engagement of the Active Director or Chairman is crucial for ensuring that the Board stays focused and provides the mentorship and oversight to management which might make the difference between success and failure. This is one of the pivotal reasons for assembling these Board documents and philosophies.

The time and energy commitment of the Chairman then becomes a pivotal issue for the Company its Board, and its Chairman. Please see related documents [Director Compensation](#) and [Director Investment](#).

Supplemental Director: All of the Directors bring their experience in one or more of the functional areas in which the company needs mentorship. As the Supplemental Director is usually the last one selected, the primary selection criterion should be in filling the most significant hole in the management team not covered by the other directors. Specifically, if there is a choice to be made between reputation and expertise, for this appointment, the expertise should predominate.

## 7. Experience and Qualities of Directors

In addition to their qualification to serve specific roles, independent directors should have some or all of the following attributes:

- Be a mentor, advisor and confidant of the CEO. As noted throughout this blog, this is the significant difference in the profile of the director of an early stage tech company as compared to a more mature company.
- Have C-level executive experience in building a management team which has developed a product and gained customer traction; and preferably has achieved operating break-even. In this previous experience, s/he will have encountered and solved many of the early stage challenges that the CEO may be encountering for the first time.
- Has raised external financing. If there is one attribute that distinguishes successful start-up CEOs, it is the ability to craft and deliver a compelling value proposition that will convince a sophisticated angel to invest in the company. The others run out of money or never get off the ground.
- Has domain experience in your industry. Industries have their own unique characteristics; aggressive or conservative, length of sales cycle, concentrated or dispersed, culture, etc. Much time and money can be saved by a knowledgeable director guiding inexperienced executives away from unknown dangers.

The personal characteristics of the Director are more important than the experience and qualifications they bring. A Director must have **integrity**: honest, transparent, and fair, with no hidden agendas, and no information withheld. She must also be **smart**: understand

the conflicting considerations in an issue challenge the CEO's thinking and be able to advise the CEO on the best course of action, which is much different than quick responses based on limited thinking. He must also be a **mentor**, as mentioned throughout this document: offer constructive criticism, but always in an attitude of support; someone the CEO can trust not to use confidential information against them.

There is a debate in the tech start-up industry as to whether it is better to have Board members with start-up experience or industry domain experience. Many would argue that rapid change and need to make quick decisions in the absence of complete information transcend all domains and is the better experience to have. Others may counter that understanding the industry better would avoid many of those problems altogether.

#### 8. Geographic Considerations.

Not all of the best directors live in town. The pool of qualified directors is significantly larger if geography is not an issue, but there are downsides as well to distant directors. Practically, early-stage companies usually will not have the financial resources to fly directors to town and pay their expenses to attend meetings. The only option is to hold Board meetings by teleconference. Teleconference board meetings are significantly less effective in dealing with difficult issues. Please see related document [Physical Presence or Teleconference](#).

In addition, the engagement and effectiveness for out-of-town directors for early stage tech companies is significantly less for practical reasons: because they are not physically available to visit the company on short notice (or at all if the company is cash-constrained), it is difficult for Directors to form a bond.

Thus the continuous contributions that actively engaged directors need to make to early stage companies are significantly negated by geographic distance. As the companies mature, the requirement for timely and direct engagement reduces, and the geographic limitations become less important.

### 3.1 Time Commitment

As described throughout these documents, early stage tech companies need the pro-active and diligent involvement of their Boards of Directors to improve their performance. There is a greater requirement for early-stage Boards which translates into a greater commitment of time and energy.

Chairman: To be effective, a Chairman will be active in many functions, including but not limited to those listed below:

- Meeting with and mentoring the CEO;
- Reviewing Board meeting agendae;
- Preparing for Board meetings;
- Chairing Board meetings;
- Keeping informed of the Company's business;
- Communicating with other Directors;
- Recruiting Directors;
- Financing;
- Making introductions for the Company;
- Representing the company at industry functions.

Chairmen should expect to devote 15 – 25% of their working time, or an average of a day a week. This is an onerous requirement, reflecting the significance of the Chairman's contribution to the performance of the CEO and company.

Directors: Directors will have less of a role in communicating with the CEO and planning Board meetings, but will have the same requirements for preparing for and attending Board meetings, keeping current on the company's business, making introductions, and financing.

Directors should expect to devote 5 – 15% of their time.

These time requirements relate directly to Chairman and Director compensation which are discussed at [www.angelblog.net](http://www.angelblog.net).

### 3.2 Director Compensation

As described throughout this handbook of articles, the demands on the time, energy, and reputations of Directors of early stage technology companies can be heavy. Please see related document [Time Commitment](#). There is also the growing debate about whether directors should make a meaningful investment in the company. Please see related document [Director Investment](#).

In recognition of increased demands on Directors, there is a trend toward significantly increased compensation. The topic is hotly debated. Here is one rule of thumb: directors should be awarded 0.5% of the fully-diluted equity of the company for each year of service, typically 1.5% for 3 years in the form of options on common shares with a strike price set at the fair market value (this is important for tax reasons and may be a requirement of a shareholders agreement, if one has been adopted). The Chairman should receive 50% more for his extra service. The options should vest as follows: 0.5% immediately (since the Director's reputation is at stake from day 1) and the balance of 1% vesting evenly over months 13 – 26. All unvested options vest immediately on change of control. If the Director leaves, she keeps her vested options with no requirement that they be exercised.

After 3 years, the Director should be awarded a new, similarly-structured option to maintain the 0.5% per year award.

In early start-ups when little equity has been issued, a different rule may apply: The company can reserve a 10% of the fully diluted shares for a Director's pool, so that the Directors can be topped up if there is significant dilution after their appointments.

In Canada, Directors are treated as employees for tax purposes. This means that they can be awarded shares instead of options with no immediate tax consequences. If all relevant requirements are met, the tax may be deferred until the year in which the shares are eventually sold. If the shares are held for more than 2 years, then the capital gains portion of the profit can be exempted under the rules for Canadian Controlled Private Corporations, and the employment income portion may be taxed at half the normal rate. *NB: The foregoing should not be construed as tax advice and all companies and directors should avail themselves of advice from qualified practitioners.*

If the Company and Directors are eligible for this favourable tax treatment, then the percentage of equity awarded as shares can be less than the 1.5% amount referenced above, since the Director will not need to pay to exercise her options.

Typically, Directors of early stage companies are not awarded cash stipends, only equity, so their interests are transparently aligned with those of the shareholders who elected them. Directors may receive additional compensation for attendance at Board and Committee meetings, although that does not typically arise until the company enters the venture growth stage.

### 3.3 Director Investment

Whether Directors should have a personal stake in the company has been debated for years. There is a growing consensus that in early stage tech companies, Boards perform better if the Directors are personally invested.

Many companies take the view that a Director is required to act in good faith in the best interests of the company, to be fully informed of the material issues, and to protect the interests of the shareholders. Once appointed, the director is investing his time and expertise, and has 100% of his reputation riding on his performance as a director and the success of the company. If the director is giving his reasonable efforts to the task, nothing more can be gained by requiring him to invest his money as well. Many directors take this point of view and resist investing their own money, whether or not they can afford to.

In large companies, this argument can carry the day. In small tech companies, however, the requirements of Boards and Directors are more onerous. Because of the inexperience of management, and holes in the management team, directors need to invest more time and energy to bridge the gaps. Inevitably, the company will face a crisis from time to time, whether it is strategic, financial, an issue of governance, or a disagreement among the Board or with management. It is all too easy for a director to resign in the face of seemingly irreconcilable differences, or the challenges of survival and growth in a tech company.

But if the director has made a personal investment that is significant for him, then the stakes are higher. He is less likely to resign, and/or less likely to be forced off the Board. Further, in recognition of the significant investment in time, energy, and personal capital required to be an effective director in a start-up tech company, directors are also compensated higher. Please see related document [Director Compensation](#).

Therefore, a director who resigns not only loses oversight of his personal investment, but also walks away from significant equity compensation. There is a much greater personal onus to weather the storm and continue to resolve the critical issues.

While a committed Board should benefit the company by forcing solutions to difficult issues, it can also backfire. Where there are opposing entrenched positions on important issues, and no one steps aside, the consequences can be severe. Paralyzed by Board fracture, the company often has no conclusive mandate. Often significant time and energy of the management team, the CEO in particular, are spent attempting to resolve Board issues for which they are usually ill-equipped and always at a power disadvantage. Companies have failed in the process.

The arguments for and against Director investment are not clear cut. However, the arguments in favour of requiring Directors to invest are stronger. Companies that institute this practice would likely not be criticized, but companies that do not often are.

Also at issue is the timing of the Director's investment. Many excellent directors do not want to invest at point of joining a Board but often make a significant investment later on. The issue for them may be to find the optimum point on the risk-reward curve: they may be prepared to risk

time and reputation at an earlier, riskier stage in the company's development than the stage at which they are prepared to risk a capital investment. A later, larger investment might be viewed favourably by other later stage investors, and can anchor a significant financing round.

### 3.4 Board and Management Responsibilities

To improve the performance of the company, the Board and management need to have a mutual understanding of their respective roles and responsibilities. Fundamentally, it is the role of management to make operational decisions, to properly inform the Board of material events and issues, and to seek and be guided by the advice of the Board. It is the Board's role to review the strategic and operational plans, to review progress against goals, to hold management to account for its decisions and actions, and to review performance of management.

The following list assigns responsibilities to either the Board or Management or both:

ACTIVITY	RESPONSIBILITY
STRATEGIC PLAN:	
Initiate strategic planning process	Either
Strategic planning session (off-site)	Both
Draft strategic plan	Management
Review and approve strategic plan	Board
OPERATING PLAN:	
Develop annual operating plan	Management
Develop functional plans: development, marketing, sales, human resources, facilities, and others as required	Management
Approve annual operating plan	Board
Approve functional plans	Not required
FINANCIAL PLAN:	
Develop financial forecast	Management
Develop annual budget, including revenue, expense, capital budgets	Management
Develop monthly cashflow projection	Management
Develop financing plan	Management
Approve budget, cashflow projection, and financing plan	Board
Establish limits for spending, material contracts and decisions	Board

REVIEW:

Prepare performance reports on achievement of goals and objectives of strategic plan, operating plan and budget: Management

- note variances, explain causes, suggest mitigation Management

- approve mitigation plan Board

- recommend changes in operating plan and budget Management

- review, approve (or disapprove) changes in operating plan and budget Board

Approve expenditures outside budget Board

Approve expenditures, contracts, decisions outside limits Board

Hire external auditors Board

PERSONNEL:

Hire, review, compensate, replace CEO Board

Recommend Officers for appointment CEO

Approve Officers Board

Hire, review senior management CEO

Compensate senior management Board

Hire, review, compensate, replace staff Management

BOARD AND COMMITTEES:

Recruit Directors Both; see [Board Review](#)

Elect Directors Shareholders at AGM; Board between AGMs

Appoint Chairman Board

Appoint Committee members Board

Appoint Committee Chairman Committee

Develop Committee mandate Committee

Approve Committee mandate

Board

Plan Board meetings and Agenda

see [Organizing a Board Meeting](#)

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### 3.5 Splitting the Roles of Chairman and CEO

There is much debate as to whether companies are better served by splitting the roles of CEO and Chairman. In large companies, good governance requires the roles be split, and virtually all companies do.

In tech start-ups, often the founder assumes the CEO role. He may also hold most of the equity, and therefore appoints himself Chairman as well. If the Chairman/CEO is an experienced entrepreneur and business manager with significant experience in Boards and fiduciary duty, then he may have the experience necessary to separate the roles of management and oversight. He can guide the Board in its duty, (one of which is to evaluate the CEO), and manage the company, (one duty of which is to report all material events to the Board).

Typically, however, start-up company CEOs do not have this wealth of experience, nor the disciplined mind necessary to manage both Board and management processes which can sometimes be in conflict. Too often, having both roles vest in the same individual concentrates too much knowledge and power. In such companies, other directors are dependent upon the agenda set by the Chairman/CEO for the Board. They can become marginalized, since they won't know what questions to ask that are not on the agenda. Directors, no matter how diligent, cannot spend as much time keeping current as the Chairman/CEO. Consequently, there is a great tendency to defer to the judgment of the Chairman/CEO who is better informed.

All of this is very unhealthy for the Board, directors, and the company. Best practices require the Board to provide independent assessment and oversight of management. It is the Chairman's role to guide the Board in its preparation and deliberation. There is no independence if the CEO is guiding the process. Importantly, it is more difficult for the other Board members to exercise oversight over the most powerful Director. Where contentious issues arise, the Board is hobbled in its ability to perform. In the worst case, it would be difficult for a Board to remove a poorly performing CEO if the CEO were also the Chairman.

Therefore, it is invariably the case that the company is better served if the Chairman and CEO are different people. The CEO can focus on managing the company and providing information to the Board. The Chairman in his role as mentor and overseer, can advise the CEO on alternative courses of action, question missing data, probe his analysis and decisions, advise on unintended consequences, etc. A second informed, experienced opinion will usually result in a better outcome. This is why as an important item of governance and best practice, the roles should be split. Please see related document [Relationship between Chairman and CEO](#).

### 3.6 Relationship Between Chairman and CEO

The relationship between the Chairman and CEO of an early stage technology company is complex.

**Mentor:** The Board's role is to advise and support the CEO. In an early state tech company, the CEO is often also the founder, and is typically young and energetic, but inexperienced in many of the functions he needs to perform. In particular, the relationship with his Board and Chairman likely need development. For this reason, the Chairman should ideally be an experienced technology executive and a former or current CEO.

As a mentor, the Chairman should be a confidante for the CEO; someone that the CEO can come to for advice on the many challenges he faces. There must be explicit trust between the CEO and Chairman, or else the CEO will not be able to confide in the Chairman.

To facilitate the mentorship, the CEO and Chairman should meet or converse at least weekly. This will allow the Chairman to keep current. The CEO must alert the Chairman to any material issues that could affect the company's performance. This is the best time to seek and be guided by advice. This is also the opportunity to identify issues that should come to the Board at the next meeting.

If a problem is identified at a Board meeting of which the Chairman did not have prior knowledge, then that is a clear indication that the communications between the CEO and Chairman are not as frequent or as strong as they should be. A worse situation would exist if the Board became aware of a material problem that had not been disclosed to the Board or Chairman.

That said, the CEO must use discretion in identifying which issues to bring to the Chairman's attention. It is not the Chairman's job to review every operational issue; that is management's responsibility. The Chairman should be consulted on the material issues which affect the performance of the Company, where the decision or action is not obvious, or where the CEO does not have the requisite experience or skills to manage the issue.

**Overseer:** The Chairman also reviews the performance of the CEO. Formally, this is done at least annually under the control of the Compensation Committee. Please see related documents [Terms of Reference for Compensation Committee](#) and [CEO Review Process](#). On a regular basis, and as required, the Chairman should review with the CEO his actions and decisions. The objective is to improve the effectiveness of the CEO and the quality of his decisions.

The Chairman should take the opportunity to provide constructive criticism of the CEO's performance, commending the good work, and suggesting how improvements might be made. The Chairman's approach in this role is important. If the Chairman criticizes a decision or action that, with 20/20 hindsight proved to be a poor one, without providing any insight as to how the situation might have been analyzed differently at the outset, then he is not adding value or helping the CEO to improve. He might lose credibility quickly which compromise his ability to continue as Chairman. Rather, the Chairman should review the facts and the thought processes

leading up to the decision or action, the timeframes, the risks involved, and whether the risks might be mitigated. An analysis of the action or decision can only be useful in the context of the information and risks known at the time. There are always unknowns and risks. It may be that a thorough analysis leads to a decision that turns out poorly because of the risk involved: "right decision, wrong outcome". This is not a management mistake.

The CEO would be in error if he fails to consider the available information or risks and consequences prior to taking the action or decision. The Chairman's role is to help the CEO to improve his processes so that there is a better chance that the actions and decisions will lead to positive outcomes.

Potential conflict in roles: Ultimately, the CEO is judged on the quality of his actions and decisions, among other things. It requires maturity and discipline to seek mentorship from the same person who judges his performance; the Chairman's roles do conflict. Since it is the short supply of maturity which creates the need for stronger mentorship of early stage tech CEO's, the Chairman should be vigilant for signs that a CEO may be struggling yet unwilling to ask for help. He should use a gently proactive approach to help the CEO identify and articulate the major issues with which he made help, and of which the Board should be made aware.

Trust is everything: One thing is certain. If there is not a high level of trust between the Chairman and CEO, then virtually none of the benefits of the Chairman's experience will accrue. The CEO will be reluctant to confide, and issues which could benefit from the Chairman's experience may not surface until they become crises which could have been avoided. The premise of all of these documents is that early stage companies need a high level of proactive involvement of an experienced Board. Without the trust to allow this to happen, the effectiveness of the Board may be fatally compromised.

### 3.6.1 What the CEO Should Expect from the Board

The previous section [3.6 Relationship between the Chairman and CEO](#) can be expanded to discuss the expectations the CEO should have from the Board at large. Brad Feld in his landmark book: “Start-up Boards” quotes the CEO of JumpCloud<sup>[1]</sup> in listing 6 fundamental requirements which are paraphrased below:

- **Support:** The Board must be unequivocally supportive of the CEO in public and in private. The CEO cannot feel confident in his decisions unless he knows the Board is backing him fully. Undermining the CEO, apart from unnecessary creating conflict, can degrade morale of the entire team and hurt the performance of the company.
- **Availability:** As mentioned in [3.1 Time Commitment](#), Directors need to be available on short notice to deal with issues quickly.
- **Strategic Advice:** Start-up CEOs often do not have the experience and depth to formulate strategic and exit strategies, especially when they are mired in the daily administrivia of a growing business. Directors, with experience and time to consider options, must provide strategic advice in terms of the company’s value proposition, market opportunity, stage of development, etc. to guide the company and management in the right direction. This is a key expectation for Directors to fill a crucial role.
- **Contacts and Relationships:** Directors with years of business experience have contacts and relationships which can help the company.
- **Governance:** With quickly changing events, management can often overlook the checks and approvals instituted to ensure that there is due consideration before proceeding. Monthly Board meetings, and continuous communication between them, give Directors the opportunity to probe management’s thinking and give timely advice.
- **Balance and Harmony:** Boards work best when there is a diversity of opinion that is sought and respected, and synthesized into a considered advice to the CEO. It is the responsibility of the Board to develop a consensus, and not leave the CEO with conflicting advice and opinion.

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[1] “Start-up Boards: Getting the Most Out of Your Board of Directors”, Brad Feld, Mahendra Ramsinghani, Wiley, 2014.

### 3.7 CEO Review Process

#### 1. INTRODUCTION

- 1.1 The evaluation of the Chief Executive Officer (the "CEO") is one of the most important responsibilities of the Board. The evaluation process provides a formal opportunity for the Board and CEO to have a constructive discussion regarding the performance of the Company and the CEO's leadership.
- 1.2 Performance evaluations are most effective if the review is conducted by the Board, the CEO him/herself, and the CEO's reports, a so-called "360 degree" review.

#### 2. BENCHMARKS

The following constitute the benchmarks against which the 360 degree review takes place:

- 2.1 A written statement of the CEO's personal goals for the year under review. These goals have been agreed to by the CEO and the Board at the beginning of the year under review.
- 2.2 The Company's performance against the Operations Plan which is approved by the Board at the beginning of the year under review.
- 2.3 Board approved terms of reference for the CEO.

#### 3. THE PROCESS

- 3.1 The Board will develop a terms of reference for the CEO. These are intended to be universal guiding principles going forward, but may be updated from time to time by the Board as circumstances warrant.
- 3.2 The Board approves the Company's Operations Plan and the CEO's objectives at the beginning of the year.
- 3.3 Towards the end of the year, the CEO will prepare a self-appraisal in written form of his/her performance against the Operations Plan and Objectives.
- 3.4 The CEO will also prepare and circulate to each of the people reporting to the CEO a form for the direct report to confidentially evaluate the CEO's performance. The forms will be forwarded directly to the Chairman.
- 3.5 Each Board member will contribute his/her assessment of the CEO's performance to the Board Chair.

- 3.6 The Chairman will forward the CEO self-evaluation, the evaluations of the direct reports, and the assessment from Board members to all members of the Board.
- 3.7 The Board will meet to review all documents and develop a consensus review of the CEO's performance, including constructive recommendations for the ensuing year.
- 3.8 The Board will then meet with the CEO to present and discuss their evaluation.
- 3.9 This process should be complete within one month of the end of the year for which the review is conducted.

### 3.8 CEO Succession

It is rarely the case that the person who founds a technology company remains as CEO from inception through rapid growth and maturity. Different skills and experience are needed at various stages of growth, as has been well documented in management literature.

Therefore, there will come a time, or several times, when the Board must replace the CEO. As recently as a few years ago, this process was often handled quite poorly. Often it would take the following sequence of events:

1. The CEO would reach his limits and begin to flounder;
2. The company's performance would begin to deteriorate;
3. Company morale would begin to suffer;
4. Company would to run out of cash;
5. Venture capital investors would refuse to invest unless there was a change in CEO;
6. The CEO was forced to resign;
7. Company morale would now plummet in the face of the stress;
8. VCs would refinance – founders, employees, and angels would be diluted;
9. Company morale would be at rock-bottom;
10. New CEO would valiantly try to re-energize the company, while repairing the many relationships that had been damaged, and dealing with the fall out of the CEO's departure.

Venture capitalists will admit openly that this process usually did not work. Often the damage to company credibility with its customers and employee morale could not be overcome.

Implicit in the spiraling sequence depicted above is the fact that the Board is a passive observer or mildly acquiescent to the process. If, however, the Board had been effective, the process would be much better, and the outcome likely better.

First, the Board needs to be pro-active in reviewing the skill sets needed in the CEO at the current and next stage of growth of the company, i.e. it needs to develop a succession plan. The current and future strengths and weaknesses in the incumbent CEO should be identified early. This gives the Board the information and time it needs to provide additional training for the CEO, hire senior management to plug the holes, or recruit Directors who can advise the CEO in the areas where he needs help. This process might prolong the CEO's tenure, and obviate a

degradation in the performance of the company caused by the missing skill sets. This is an example of the Board being effective.

Nonetheless, the Board may decide that the CEO does not have the skills and cannot acquire them, and therefore needs to be replaced. Again, this is not a decision that is made under stress, but is planned well in advance to avoid a crisis. The CEO must be fully involved in this assessment, which may occur as part of an annual performance review

Ideally, the very best way to recruit a new CEO and to manage the transition to new leadership, is for the CEO to manage the process himself. This demonstrates to the company his commitment to the change and should mitigate an adverse reaction from staff. Often there is a role for the departing incumbent as the Chief Technical Officer or other functional role, or a position on the Board.

But there is a subtle danger. If the incumbent is not ready to relinquish the reins but is not prepared to oppose the Board, he can pay lip service to the process but then not effectively execute it. As long as he is in charge of the recruitment process, it can take forever, and never find the ideal candidate. This leads to a longer-term malaise in the company as everyone views the CEO as a lame duck while the process drags on.

Should it not be pragmatic to have the incumbent manage the recruitment, the Board should strike an ad-hoc recruitment committee, which may be Compensation Committee. The Board should announce that a search is underway and indicate the future role of the incumbent. The more transparency in the process, the greater the support. The recruitment committee will be guided by the succession plan. Again, the Board is effectively managing the process and mitigating potential negative consequences. It is not left to the investors to react to a poorly planned transition.

### 3.9 Founder's Syndrome

Technology entrepreneurs are typically high-energy, confident people, or else they never would have taken the risk to found a company. While this strength of character is essential to driving the Company through the many challenges to success, it has a dark side. Many entrepreneurs believe they have all the answers and resist advice. They also want to make all the important decisions themselves, and frequently over-rule decisions with which they do not agree. This frequent phenomenon is termed "Founder's Syndrome". This behaviour typically prevents the company from growing larger than a small size defined by what can be accomplished by a single, driven founder.<sup>1</sup> Often it causes the company to become one of the 80% that fail to achieve their expectations.

Worse, founders often realize that they need to take advice and delegate decisions, and resolve to do so. They hire senior executives and strengthen their board. Often, they may cede the CEO position to an experienced manager. However, as well-intentioned as these actions are, when confronted by an important decision with which they do not agree, they may grab back the controls, cursing the day that they listened to people who didn't understand the situation.

This is one of the occasions where the intervention of an experienced Board may be crucial to making or breaking the company. First, the frequency with which Boards have to deal with Founder's Syndrome may in fact be reducing. Angels and venture capitalists are becoming much more adept at recognizing founders who believe they know it all and won't take advice and can't effectively delegate. An entrepreneur who is tagged as "uncoachable" usually does not get funded, and cannot attract a professional Board. Sometimes, these founders can struggle for years before coming to terms with their own limitations and then accept the advice and assistance of other professionals. If they don't, their companies often struggle miserably.

However, Boards may find themselves in a situation where the Founder/CEO, often under the pressures of growth or challenges of setbacks, begins to pre-empt decision-making processes, over-ride his managers, take on more work, and start to exhibit signs of stress. These are typical symptoms of Founder's Syndrome. The Board needs to act, but judiciously.

The first action should be for the Chairman, as the director with the strongest relationship with the CEO, (please see related document [Relationship between Chair and CEO](#)) to take the CEO off-site for an informal coaching session. In his role as mentor, the Chairman should empathize with the pressures of the CEO's job, and the current challenges in particular. He should note where the CEO's approach may be counter-productive and offer suggestions for improvement. The Chairman should meet with the CEO briefly, but weekly, to review progress. A coachable CEO should be able to take the advice and put it into practice. The obvious danger is that the Founder/CEO may become defensive, and cut himself off.

Often, however, this may not be enough. It may be a tall order to overcome the controlling tendencies of strong individuals in times of stress. It may take time. The Board, through the Compensation Committee, may establish a formal, written performance improvement program for the CEO. Progress should be measured by objective surveys completed by the Board and senior reports. Considerable care will be needed in implementing and monitoring the program so

as not to diminish the credibility and authority of the CEO. Experienced Human Resource professionals may need to develop and administer the program. There may be no quick fix to the issue. However, if the CEO's approach does not worsen, and shows measurable improvement, even if small, then the appearance of the change may be as welcome as the change itself, and a crisis may be avoided.

Far too frequently in early stage technology companies, even the performance improvement process does not produce the needed changes. The Board may conclude, with regret, that the Syndrome is impeding the company's progress and it cannot be changed within the individual. The CEO must then be replaced. Please see related topic [CEO Succession](#).

In venture-backed companies, the shareholders agreement may specify that the preferred shareholders, meaning the venture capital investors, have the right to hire and fire the CEO. (In negotiating the shareholders agreement, companies should strive mightily to retain this responsibility with the Board, or else the Board is essentially neutered.) Were the shareholders to lose confidence in the CEO before the Board, then an irreparable rift could occur on the Board. This could devastate the company from the stress on the CEO, senior management and the Board. This is a situation which experienced Boards should be able to avoid.

The important point for Boards in this discussion is to be aware of Founder's Syndrome and the significant detrimental impacts it can have on the company. Only the Board can effectively deal with the situation, and the Board must act.

<sup>1</sup> For more information on the stages of company growth, please see the seminal article: "Evolution and Revolution as Corporations Grow", Larry Greiner, Harvard Business School press, [harvardbusinessonline.hbsp.harvard.edu/relay.jhtml?name=itemdetail&id=98308](http://harvardbusinessonline.hbsp.harvard.edu/relay.jhtml?name=itemdetail&id=98308).

### 3.10 Authorization Levels

For start-up companies, financed by friends and families or angels, there should be limits on the ability of individuals to spend the company's limited funds. There are no absolute levels that are right in all situations. Here is one set of limits for the approval of expenditures at certain levels:

- Up to \$100: any employee
- Up to \$1,000: any manager
- Up to \$10,000: any Vice President or Officer
- Up to \$25,000: one Vice-President or Officer plus CFO or CEO
- Up to \$50,000: CFO plus CEO
- Over 50,000: Board of Directors

Entering into any contract requires the same approval levels based upon the expected cumulative expenditures over the life of the contract.

### 3.11 Risk Assessment

As the depth of Board oversight continues to increase, an area that is receiving more attention is risk assessment and risk management. Inevitably, this task will devolve to the CFO. He will then be responsible for identifying the sources of risk and developing plans to mitigate them. The Board may wish to hear and question a report on risk from the CFO from time to time.

In a tech start-up, the risks are legion and the ability to manage most of them is often limited by few resources. However, current thinking is that early-stage companies can and should manage the following risks:

1. Intellectual Property: For a tech company, the IP are its family jewels. Key innovations should be patented or trade-marked, if feasible. Importantly, all employees and contractors must have in place an employment or consulting agreement which clearly transfers all IP to the company.

The due diligence performed by potential investors and inquisitors will focus heavily on this area. If the risk of leaky IP appears to be too great, then the potential investor or buyer may withdraw, as they are loathe to take the risk that the IP could partially reside with entities that are not controlled by the company.

2. Contracts: There are standard form distribution contracts, joint-development agreements, manufacturing license agreements, etc. Companies can beg, borrow or steal templates of standard agreements from other companies to avoid the heavy expense of developing them from scratch with a lawyer. All material business must have contracts in place to protect the company's interests should events not turn out as expected.
3. Employment agreements, incentive plans, equity plans: The relationship between the company and its employees, and between their performance and compensation needs to be clearly laid out in contract form. There is no greater negative impact on morale than for an employee to discover that his extensive efforts do not result in the reward he was expecting because the rules were not well established.

Most companies implement employee stock option plans early on in their development. A stock option plan must be in place before options are granted, or the company risks compromising the integrity of its capital structure. This is not only an embarrassment, but is quite expensive to fix later to support a professional financing.

4. Management Information Systems: Pulling the plug on the server, or crashing a disk drive should not put the company at great risk. Backup systems and disaster recovery plans should be in place and tested.
5. Building and equipment insurance. It is relatively simple to purchase insurance for standard perils.

The Board's role is to request management to report as to the state of its risk identification and mitigation. It may be important to have management report on not only the risks they have mitigated, but also the risks that have been identified, but will not be mitigated and the reasons why. This is part of the due diligence that the Board should do in its fiduciary duty to protect the company.

### 3.12 Strategic Planning

A pivotal role of the Board of Directors is to provide leadership in the development and execution of a Strategic Plan. Oversight by the Board will assist in creating the conditions for success by fundamentally ensuring that there exists alignment with strategic direction, that expectations are realistic and that risks and opportunities are capable of being managed throughout the timeline of the plan.

What must be clear from the outset is the role both Directors and Management play in the process of developing the plan. The Board needs to confirm and endorse the CEO as being the responsibility centre for the process leading to the development of a Strategic Plan. The Chair of the Board of Directors must work with the CEO to develop ways of educating and engaging Directors so that the latter may be knowledgeable about this key process and can be constructive participants in the deliverable.

The Board will need to find a common ground with their understanding of strategy and strategic planning. They will need to agree the timeline or horizon for the Plan (e.g. 2 to 5 years). They will need to ensure a commonality of purpose and thought so that they are moving forward in sync with Management – that is they ought to share the same notion of vision, mission, goals, objectives and priorities. They must be capable of critical and lateral thinking in the context of challenging assumptions, ensuring understanding and making improvements.

Management must adhere to the guidelines and boundaries as defined by the Board and seek clarification where necessary. They must also present the Plan to the Board for review, input and approval. They should understand the Plan in detail and be prepared to respond in detail to reveal alternatives that were considered.

Later versions of this document will provide links to detailed discussions of the process to develop a strategic plan. For this initial version, it is noted that the strategic planning process requires significant time and energy for both Management and Directors, may require the input and guidance of experienced facilitators, and is so important that it needs to be conducted off-site where the planners can devote 100% of their attention over a few days.

### 3.13 Whistle Blowing

At the heart of any "Whistle-blower" policy is the protection of an organization's reputation and good standing. As a result of many recent spectacular business scandals it is apparent that organizations need to stress the importance of honesty and cultivate a culture that underscores ethical behaviour. Accordingly, any organization would be wise to formalize a framework that establishes expectations for ethical behaviour in order to preserve the integrity of the particular entity.

Every employee should be encouraged to report any incident involving, wrongful, harmful, illegal or unethical actions or communications. The organization should encourage "reporters" to discuss such situations privately with someone with whom they have established a comfort level. This individual will hopefully be a Supervisor, Manager or Officer of the organization.

Organizations may wish to consider the appointment of an ombudsperson or perhaps an Independent Director of the Board to whom such reports could be made, especially if the "reporter" is fearful of retribution or retaliation. The arms-length relationship must be built on trust wherein there is a guarantee that, under no circumstances, will the identity of the "reporter" or "accuser" be revealed.

In a larger context everyone in the organization must know that retaliation in any form is unacceptable and will result in disciplinary action, up to and including termination.

The Whistle-blower policy should detail the steps that any reporter should follow if they believe that there is an ethical problem which needs to be exposed and corrected. The process for the reporter, and the actions taken by the company in response need to be clearly explained and widely disseminated. This will reduce the fear which comes from uncertainty about the process and its consequences. The draft policy must be reviewed and approved by the Board.

Importantly, the policy must be implemented in a company meeting with the full support of the management team, CEO and Board. The Chairman or another director should be at the meeting to launch the plan to demonstrate the highest level of commitment to the policy and process.

### 3.14 Advisory Committees

Advisory Committee: There is a role for an Advisory Committee. However, it is not to take the place of the Board.

Some companies appoint knowledgeable people to an Advisory Committee to gain the benefit of their expertise without exposing them to the liabilities and routine requirements of Directors. Typically, however, in tech start-ups, there is little bandwidth among management, while running the company and reporting to the Board, to properly prepare an Advisory Committee to delve into important issues. Communication tends to be one-on-one with Advisors without the benefit of discussions that can generate a better solution. While expert Advisors can often provide valuable input on specific issues, the Committee is usually not as effective as it could be.<sup>1</sup>

Importantly, with little investment in the company either monetarily or with liability and reputation at stake, there is little incentive for the Advisors to participate meaningfully. An Advisory Committee does not owe a duty of care to the company or the shareholders, and does not have the mandate to oversee management and hold it to account. Consequently, it cannot perform the functions of the Board.

When companies promote their Advisory Committee as a surrogate for a Board, investors and other stakeholders are not impressed.

See related topics [Requirements for Directors](#).

Professional Advisors: It is becoming common for CEOs of early stage tech companies to hire professional advisors to provide the mentoring and advice typically provided by the Board. Indeed, there are programs fostered by angels and early investors to promote the engagement of advisors in lieu of the Board. The belief is that Boards are cumbersome and ineffective. CEOs can more efficiently gain the help they need with an advisor hired and responsible only to him, without ceding control and copious amounts of time to such a Board.

CEOs should obtain assistance and advice in a manner that is most effective for them, of course. However, the formal process of reporting up to a Board and being held accountable for decisions and actions is a discipline that cannot be replaced by an advisor beholden to the CEO.

An advisor if helpful, but a Board for certain.

<sup>1</sup> In biotechnology and medical device companies, the scientific and/or medical advisory committee is typically better organized and serves a meaningful purpose.

### 3.15 Holding Management to Account

It is the Board's role to hold management to account for its decisions and actions, and to review performance of management. In the course of business, the Board may determine that management has failed in its duties, over-stepped its authority, or mis-guided the Board. The following is a partial list of items where the Board may feel it needs to hold management to account:

- Management withholding information from the Board, such that they do not have all of the material information necessary to exercise their fiduciary duty.
- Management failing to abide by the Board's direction. If the Board has approved a course of action and management does not follow through, or willfully disobeys, this is a serious breach of the Board/management relationship.

Incidentally, Board direction need not only be given in the context of a Board meeting; it can occur in conversation between management and the Board between Board meetings. This may occur if there is an urgent item to be decided which cannot wait for a Board meeting.

- Management not referring material issues to the Board for review and approval. In venture-financed companies, there is nearly always a shareholders agreement, and one can often exist if there are multiple shareholders and investors even without a venture capitalist. The shareholders agreement will list certain items to be referred to the Board for approval, and others to be approved by the shareholders. The Board must also approve the shareholder items.

In the absence of a shareholders' agreement, the Board should define certain items which it must approve.

Should management act without the requisite approval, then they may be in breach of both the Board/management relationship and the shareholders agreement.

- Spending money outside the approved budget or making material decisions which require Board approval without seeking Board approval.
- Actions prejudicial to the interests of the company.
- Violations of company policy, including the Code of Conduct.
- General mis-management or dereliction of duty.

This is not meant to be an exhaustive list. Should one or more Directors reasonably believe that there is a risk that one of these events may have occurred, they may wish to call a meeting of independent directors to review the situation and determine a course of action.

While the transgressions listed above seem dire, it is important for Boards to exercise discretion and restraint in dealing with these types of issues. Often the errors arise from a lack of experience in times of stress. Wherever possible, the incidents should be used as an opportunity

to learn and to strengthen the management and Board and their interaction. Disciplinary action should be a last resort and applied only in cases where there has been willful misconduct.

Where disciplinary action is warranted, after a full airing of the facts, the Board may wish to consider a progressive series of actions:

1. Informal chat between Chairman and CEO in the form of constructive criticism.
2. Verbal reprimand from the Board to the CEO in an informal meeting so as not to be minuted.
3. Formal written reprimand from Board to CEO in a Board meeting which is minuted.
4. Request from Board for CEO to tender his resignation.
5. Board formally terminating the CEO for cause.

### 3.16 Board Review

Well-functioning Boards should have a process in place to regularly examine how it is performing. A regular review identifies or highlights problems of which the Board may not be aware, or improvements that could be made. Given the pressures of time on Directors, and the number and variety of issues with which Boards of early-stage tech companies must contend, this task usually falls into the category of "important, but not urgent", and often does not get done.

The Board review involves all Board members and should be managed by the Chairman who should also chair the Governance Committee if the Board has appointed one. The purpose is to identify strengths and weaknesses, and to institute improvements to weak areas the Board identifies.

The review is best done half way through the fiscal year. This allows new Board members sufficient time to become familiar with the company and Board system, and leaves enough time before the next Annual General Meeting for improvements to be made, and to search for new directors, should that become necessary.

The Board review process can be simplified by using a standard questionnaire. Attached as Appendix A is a series of questions Board members can use to quantify the Board's performance in several areas.

#### APPENDIX A: SAMPLE BOARD REVIEW QUESTIONNAIRE

	Exc.	Very Good	Avg.	Needs Impr.	Sig. Prob.
<b>ROLES</b>					
Directors understand the roles of Board and management.					
Management understands the roles of Board and management.					
Directors are sufficiently well-informed of Company strategy, plans, and business.					
<b>COMPOSITION</b>					
Board regularly compares skill sets of Directors to changing skill sets required by Company.					
Directors are appointed for their experience and contribution to the company.					
<b>COMMITTEES</b>					
Board has the right Committees in place.					
Audit Committee is effective.					
Compensation Committee is effective.					
Governance Committee is effective.					

MEETINGS					
Board meets as frequently as necessary.					
Meeting agenda and reports are distributed sufficiently in advance.					
CEO, Chairman and Secretary review Agenda prior to meeting.					
Meetings are run effectively.					
Meetings focus on material company issues.					
INFORMATION					
Board receives the information it needs to exercise its mandate.					
CEO's Report succinctly identifies material activities and issues and management's response.					
CFO's Report succinctly presents financial status and forecast.					
STRATEGY AND OPERATIONS					
Board reviews strategic plan as required and no less than annually.					
Board approves annual operating plan and budget.					
Management reports results against operating plan quarterly.					
Management reports results against budget monthly.					
FIDUCIARY DUTY					
Independent Directors meet in-camera.					
Board has sufficient independence from management to exercise oversight.					
Directors declare conflicts of interest.					
Directors act in the best interest of the company and all shareholders.					
CEO and management seek advice of Board.					
Board provides guidance to CEO and management.					
Management heeds advice of Board.					
Board reviews CEO performance.					
Board approves compensation for senior management and Officers.					
Board receives risk assessment report.					
TIME AND COMPENSATION					
Directors devote appropriate amount of time to Board and company.					
Directors are compensated appropriately.					

## PERSONAL NARRATIVE

1. Describe successes and needed improvements for the Board:
2. Describe personal successes and areas for improvement as a Director:
3. What factors contributed to your performance or lack of performance in the areas above: (please be specific)
4. Other comments or suggestions to increase effectiveness of the Board?

### 3.16.1 Directors Matrix of Skills

Matrix of Skill Sets and Potential Board Members

Name	Background	Director Experience	Corporate Governance	Hi-Tech CEO	Marketing	Sales	R&D	Finance	Angel Investor	Industry Name	Business Name	Reputation Director	Active Director	Supplemental Director	Category Points	Status
Candidate 1	<<brief description>>				1	1		1	1	1	1				6	
Candidate 2		1	1	1				1	1	1	1				7	
Candidate 3					1	1		1		1	1				5	
Candidate 4		1	1	1				1	1		1				6	
Candidate 5		1	1			1		1			1				5	
Candidate 6		1	1	1					1		1				5	
Candidate 7		1	1	1							1				4	
Candidate 8							1		1		1				3	
Candidate 9		1	1								1				3	
Candidate 10		1	1	1				1							4	

### 3.17 Governance Practices by Stage of Growth

Governance evolves. The entire content of the [earlystagetechboards.com](http://earlystagetechboards.com) website is to provide a manual and a set of best practices for early stage technology companies to obtain the best value from their Boards of Directors. Governance, however, is not static. Technology companies may start out with only rudimentary, if any, governance system. Over time, as the company grows, its governance practices must evolve to ensure that the company and its management are performing to ever higher standards and receiving the oversight and advice that are appropriate to that stage of the company's development.

Too often in the rapid change and hard work that characterizes early stage technology companies, governance is neglected. The needed documentation and oversight are not considered or implemented until a problem is uncovered which jeopardizes a major transaction or an exit.

Problems with poor documentation. For example, in a typical tech start-up, all of the focus is on the development of the new product. Scant attention is paid to accounting. Shares and options are distributed widely because there is no cash to pay people. Later, when the founders look to angels to finance the company, they are stopped in their tracks when the angel asks to see the financial statements and the share cap table. The longer the gaps in the documentation exist, the greater the consequences. As the company progresses, it may look to negotiate a financing or strategic partnership. To close the deal, the company's lawyer must write a clean legal opinion that all of the shares have been validly issued. If there is not a clear paper trail formerly authorizing the issuance of all shares and options, he cannot deliver a clean opinion and the deal may crater as a result.

Serious consequences. That said, early stage companies don't have the resources to put in place the sophisticated documentation and governance systems required of more mature companies. It may be helpful to explore the governance artefacts and systems which early stage technology companies should adopt at various stages of growth. The discussion which follows is summarized in the chart attached in section 3.17.1.

Essential practice: IP assignment. To begin, from the date the technology company is founded, it is imperative that every founder, employee, director, contractor and advisor sign an intellectual property (IP) assignment agreement which assigns all rights and title to the company for any and all technical and business development done in the context of their association with the company. There is no touchier subject for investors and acquirors than IP. The company must be able to show that every person or company who ever contributed to the IP has assigned all rights to the company. This eliminates the possibility of some long-departed employee emerging years later to assert IP rights just as a transaction is about to close. It can be expensive and time-consuming to deal with those alleged rights, and many potential acquirors would rather pass. Best to eliminate the problem from the outset. Buy or beg someone for a template that you can use for everyone associated with the IP.

Also, it is advisable to have everyone sign non-disclosure agreements (NDAs) and non-compete agreements. This creates negative consequences for someone disclosing company secrets or

using the company's knowledge to complete with it. The IP assignment, NDA, and non-compete clauses can all be included in every employment agreement or contractor agreement. Again, buy or borrow a template.

Raw Start-up Stage. A technology company typically starts up with a couple of people with a new idea to change the world. They set up shop in a basement or lab, incorporate a company, give themselves some shares, open a bank account and settle down to the risky business of wiring circuit boards or writing code. Receipts go into a box. The only financial information is the monthly bank statements, if they remember to download them in time. They may be able to raise some financing from the "4Fs": Founders, family, friends and fools, in the form of subscriptions to common shares. Advice and oversight is at best the labour of love from a kindly uncle or interested friend. The hard-working founders measure their progress against the development schedule for their new project, working to get it launched before their meager funds run out. Customers and revenues are in the distant future.

At this stage, there is little governance or artefacts. All efforts are on birth, development and survival. Since the founders are accountable only to themselves and the other 3 Fs, this is appropriate.

Angel Stage. The picture should change abruptly when the first angel investor writes a cheque. At this stage, the company is showing some progress with the product. They may have captured a few innovative customers who are willing to act as beta test sites to provide feedback on the initial product. An angel investor can see a future potential and is prepared to risk a modest investment, but will likely want to see some controls and documentation put in place. An expense budget will be the first item. The company will need to hire a part-time bookkeeper to pay the bills, mind the cash, and produce an income statement and balance sheet each month, and a report on the actual versus budgeted expenses. This will provide at least a modicum of control on the company finances. The company may also discover that they have to file income tax returns and GST or HST returns at the end of the year. As the requirements increase with the company's growth, experienced accountants will need to be hired, and eventually a controller.

Until recently, angels were content to purchase common shares and stand alongside the 4Fs in the queue. Often, if valuation couldn't be agreed, the angels would make their investment in the form of a debenture which would convert to common shares at a discount, usually 20%, to the price paid by the next investor. Currently, more angels are demanding preferred shares to give themselves a preference over the 4Fs on sale of the company or its assets.

At this point, the company should formally approve an Employee Stock Option Plan before it begins to issue options to employees and directors. If options are issued before there is a formal ESOP, the accounting for stock options becomes very complicated.

This is also the time to formally constitute a Board of Directors for the company. Many would argue that the angel stage is too early for the overhead of time that a Board requires. To the contrary, the time invested by a committed and experienced Board will repay itself many times over by guiding the company and its founder managers through the multiple challenges that companies encounter at the angel stage. Directors of angel-stage companies are most effective if

they can help management deal with ambiguity and imperfect information by challenging management's thinking and advocating a course of action. The need for pro-active identification of issues and mentoring management in their response is discussed at length throughout the earlystagetechboards website.

- The Board should include at least one angel or independent director with experience in growing companies through the early stages.
- The Board should meet monthly, and spend the majority of its time reviewing the CEO's operations report which should include at a minimum the status of the development schedule, the sales funnel, and the next financing.
- The Board should also review the monthly financial statements, and a report of the budget versus actual expenses.
- The Board should formally approve all issuances of shares and options, and approve any term sheets to raise financing.
- The Board should establish a materiality limit for contracts and other transactions and formally review and approve all contracts which exceed this limit.
- All Board decisions must be captured in formal minutes which are filed with the company lawyer in the Minute Book.

The company should maintain an up to date registry to records the issuance of shares and options. Regular updates should be filed with the company lawyer for the minute book, and at least at the end of every fiscal year.

This is a lot to accomplish for a company that is undoubtedly stretched for cash and human resources. It may take a year or so to implement all of the pieces. An experienced Chief Financial Officer or Operating Officer can manage all of this as part of their regular duties but few companies at the angel stage believe that they can afford the investment in that level of experience. The return on the investment in these procedures is two-fold: first and foremost, the company will be better managed. The experienced Board can guide the company away from typical pitfalls and towards desirable goals. A regular monthly review at Board meetings forces the management team to take stock and re-focus. Secondly, maintaining proper records at this stage will avoid horrendous problems down the road when a major financier or acquirer conduct formal diligence, as noted above.

Venture Growth Stage. At the venture growth stage, the company is achieving its goals. They have proven their business model as revenues are accelerating. Early adopters are embracing the product, and the company is beginning to gain traction among mainstream customers.

This is the point at which the company used to look for a Series A round of venture capital to fund its growth. However, since the burst of the tech bubble in 2000-01 and the global financial meltdown in 2008-09, the venture capital sector has severely retreated. The asymmetry of venture capital investments is also now becoming better understood. As a result, many technology companies are looking elsewhere for expansion capital. The angel networks are

filling some of the void. Whereas angels previously invested independently and somewhat secretly, angels are now formally organizing themselves into angel investment groups. These groups aggregate the diverse talents and experiences of the angel members to improve the breadth and depth of diligence, and also syndicate investments to increase the quantum and share risk. Along with the deeper diligence and larger investments, angels and syndicates are investing more often in the form of preferred shares. Hopefully, the angels will accept a “simple” liquidation preference which on exit allows them to choose between recouping their investment with a small accumulated dividend, or, converting to common shares so that all shareholders are treated equally. Venture capitalists invariably look for a “fully participating” preference in which they receive a multiple of their investment off the top, but then also participate pro-rata in whatever is left. It will be interesting to see if angels are true to their name or become more greedy.

Financial controls and documentation increase at this stage. The company will have an experienced accounting team with segregated duties, including a Controller and CFO or Director of Finance. The investors will require the company to engage an external accounting firm, typically one of the big 4 (KPMG, Deloitte, pwc, or Ernst & Young), but they may also accept one of the excellent second-tier firms like Smyth Ratcliff, BDO Dunwoody, Grant Thornton, Meyers Norris Penney, or dozens of others. The company will need to produce full accounting statements with notes prepared according to GAAP, IFRS or ASPE, and have the external firm either review or audit them. A history of reviewed, or better, audited financial statements by a recognized firm is very reassuring to potential investors or acquirors, so the earlier the company engages the auditor, the better.

The Company’s financial systems must strengthen in this phase. The CFO must prepare an annual budget for the Board to review and approve prior to the start of the year including projection for the income statement, balance sheet and cashflow. The CFO must report variances against the budget for each month and Board meeting, with a summary discussion, and a forecast for the balance of the year. The accounting team will closely manage accounts receivable and payable to closely monitor and forecast cash balances.

The Company should compile and maintain electronically a due diligence binder containing copies of every important document in running the business. These include all material contracts, and also financial statements, share cap table, sales funnel, development plans, investor presentations, product descriptions, list of Intellectual Property, market studies, and so on. A detailed table of contents for a diligence binder is widely available online or from the company counsel. A comprehensive and well-organized diligence binder is helpful and credible to the financing and acquisition processes.

One of the most frustrating financial statement requirements which appears at this stage is stock-based compensation. GAAP, IFRS, and ASPE rules require that companies calculate an arbitrary value for the stock options which vest over the course of the year and recognize it as an expense on the income statement. The calculation is arduous as it must be performed for every stock option and adjusted if the option is exercised or cancelled. The amount of the expense is often significant and distorts the income statement. Many companies resort to reporting an “adjusted EBITDA” calculation which removes stock-based compensation along with other non-

cash charges so that readers, like the Board of Directors, can obtain a clearer picture of the company's financial performance.

Another serious challenge arises when the company starts making sales into the U.S. Most companies discover only after many months and sales go by that they may be required to collect and remit sales tax individually to each state in which they sell products or services, and in many cases, even at the city or county level. In fact, there are 16,000 tax jurisdictions in the U.S. The rules are complex and steadily tightening as the states grab every tax dollar they can particularly from foreign companies who don't vote. To mitigate the exposure, it is advisable that every contract and sales order include language that requires the U.S. customer to self-assess and remit state sales tax. Many customers, particularly large ones and government entities do self-assess, but nonetheless the onus remains with the supplier. U.S. state sales tax compliance is an area where companies should engage experienced help. The large accounting firms can help, but at significant cost. There are also boutique firms who specialize in U.S. tax compliance for small Canadian companies at more reasonable cost. If the company opens up an office, or hires employees in the U.S., they may also be required to file income tax returns to the IRS and to the state government, with large potential penalties for late filings.

As the rules tighten, the exposure grows for Canadian companies. US tax exposure is now an item of due diligence for investors and acquirors. Target companies need to demonstrate that they are knowledgeable and in compliance with U.S. income and sales tax provisions and can reasonably estimate their exposure. Companies that are not sufficiently diligent may be at risk not just from the taxes, interest and penalties, but also from the collapse of financings or acquisition.

The Board of Directors continues to broaden and deepen its oversight in this phase. The Board may be restructured to ensure that there are a majority of either independent directors, or directors appointed by the investors. The Board should constitute an Audit Committee to continuously review the financial statements, accounting policy, and preparations and execution of the annual review or audit. The Board should also strike a Compensation Committee consisting only of non-management directors to review and approve executive and Board compensation annually. The Board should continue to meet monthly until the company is comfortable generating positive cashflow.

The Company should also be holding formal Annual General Meetings to receive the financial statements, elect the Board of Directors, and in general account to the shareholders for the performance of the executive team.

Steady Growth, Preparing for Exit. Once a company has penetrated its mainstream markets, it begins to mature. It is not betting the company at every decision; it has an established base of customers, and a predictable revenue stream. Profitability is in sight, if not already there. Growth is more manageable.

With a more predictable business, the company can be run by the numbers with more focus on performance to budget. Variances can be measured in the single digit percentages.

If an investment is needed to get the company to exit, it would likely be from a mezzanine private or growth equity investor for whom steady cashflow generation is more important than growth.

If the company's goal is to exit, preparations should be well underway. (Some commentators believe that exit planning should begin on the first day of business.) The minute book should be correct and up to date and the diligence binder updated.

As the business becomes more predictable, the Board may only need to meet quarterly to review operations and the financial statements. However, if the company is actively in exit mode, the demands on directors will increase significantly. Some commentators suggest that a savvy Board can double the exit value of the company by orchestrating a competition among bidders and promoting the company's strength. There will be significant demand for the Directors' experience and time.

If the company's goal is to do an initial public offering (IPO), then the underwriter and their counsel will examine every aspect of the company in order to verify every statement in the prospectus. This is the time when the work on the minute book, taxes, share and option registry, diligence binder, etc. pays dividends in terms of shortening and simplifying the diligence component of the IPO.

Summary. The chart in section 3.17.1 summarizes the components of governance for early-stage technology companies from founding through to exit. As described herein, the requirements for proper processes and documentation can be onerous, even at an early stage of development. Companies need to implement and maintain the governance and documentation system appropriate for their growth. They ignore these requirements at their peril. Seemingly innocuous oversights can create significant problems down the road and jeopardize significant transactions. An experienced and diligent Board of Directors can avoid many common errors of early stage companies and also ensure that processes are observed and documents maintained. It can mean the difference between success and failure.

Brad Feld, a recognized expert in Board Governance for tech companies in the US, developed the following summary table differentiating the roles of Directors at different stages of growth:

**Table 3.2 The Role of Board Members at Different Stages of a Company**

	<b>Start-up</b>	<b>Revenue</b>	<b>Growth</b>
<b>Role of Board member / Company Needs</b>	Working / Active	Shaping / Nurturing	Governing / Monitoring

<b>Customer Discovery and Market Development</b>	High	Moderate	Low
<b>Product Development</b>	High	Moderate / High	Low
<b>Sales and Marketing</b>	High / Moderate	High	High
<b>Finance and Operational Controls</b>	Moderate / Low	Moderate	High
<b>Human Resources</b>	Low	Moderate	High
<b>Strategy</b>	High	High	High

From “Start-up Boards – Getting the Most Out of Your Board of Directors”, Brad Feld, Mahendra Ramsinghani, Wiley, 2014.

**3.17.1 Technology Company Governance by Stage of Development**

Phase	Stage of Development	Accounting	Legal	Board	Investors	Metrics
			from start-up on, all employees and consultants must sign NDAs, non-competes, and IP assignments			In addition to below, each company will have metrics specific to its industry and business plan; e.g. Retention and DARPU for gamers, on-time and on-budget % for enterprise software, etc.
<b>Raw Start-up</b>	in the garage or incubator or lab	Bank statements	Incorporation documents	Uncle Fred	4F's: Founders, family, friends and fools	cash runway
	no customers	no accounting			common shares	development schedule
	total development mode	tax returns late				
<b>Angel Stage</b>	Beta version or Release 1.0	part-time bookkeeper	Central Security Register	formal Board		as above, plus:
	fledgling sales to evangelists and early adopters	monthly income stmt and balance sheet	Directors' Resolutions to approve shares and options	at least 1 Angel or independent director	one or more sophisticated Angel investors	sales funnel
		later stage: Notice to Reader financial statements	formal ESOP	Monthly meetings, formal Board minutes	common shares, preferred shares (some)	expense budget variance reporting
		tax returns done	complete and correct cap table	material contract review	debt convertible at discount to next equity raise (some)	
				AGM		
<b>Venture Growth</b>		accounting team, Controller, CFO		Monthly meetings until cashflow positive, then quarterly		as above, plus:
	business model proven	accounting firm - review level	as above, plus:	majority of independent Directors	institutional investors: VC's. strategic partners	full budget variance reporting
	accelerating sales growth, penetrating mainstream	ASPE financial statements	AGMs and SGMs by the book	Audit Committee	super-angels or angel syndicate	A/R, A/P management
		Stock-based compensation		Compensation Committee	preferred shares	annual cashflow forecast
		US tax advisors: US tax returns, US state sales tax compliance		Due diligence binder	convertible debt	somewhat credible multi-year projections
<b>Prep for Exit</b>			as above, plus:			as above, plus:
	profitability in sight	audited financial statements	minute book complete and correct	as above	as above	management by numbers
	de-risking business plan	management letter	all shares and options issuances minuted	quarterly meetings	perhaps mezzanine investor, growth equity	
	organizing for exit or other liquidity event	tight controls		as exit approaches, heavy director involvement		
		no surprises				

3.17.1 Summary Chart of Governance Practices

## **Section 4**

# **Board Meetings**

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## 4.0 Organizing a Board Meeting

For a high-performing Board and management team, organizing Board meetings would seem to be a routine task. All that is required is to prepare an agenda, assemble minutes and reports from management, identify the decisions the Board must make, assemble all the documents into a 3-ring or online binder and get it to the Directors at least 5 days before the Board meeting.

Yet Board binders are often late and incomplete, resulting in Directors poorly prepared for the meeting. This impairs the effectiveness of the Board and can damage the credibility of Board and management.

The Board Secretary, who is often the CFO, is responsible for organizing the Board meeting. The Secretary cannot be effective, however, without the active support of the CEO and the Board Chairman. Here are suggestions for reducing the stress of the process.

There are tools available to assist the organizing and documenting Board meetings. See [www.aprio.net](http://www.aprio.net).

1. Establish the schedule of Board and Committee Meetings Months in Advance

This will facilitate meetings with the desired frequency and reduce considerable stress on the Board secretary.

2. Establish a Calendar of Activities for the Board and Committees

At the first meeting of the incoming Board, the Board should review the calendar of activities for the upcoming year. Each Committee should do the same. For samples of Board and Committee calendars, please see related documents [Board Terms of Reference](#), [Audit Committee Terms of Reference](#), [Compensation Committee Terms of Reference](#).

With months of prior notice of events and topics, the Board and management will have a much easier time making preparations.

3. Keep a copy of the Shareholders Agreement handy

Most venture-financed companies and many other private companies will have shareholders agreements that specify certain issues that require approval of the Board or certain shareholders. The CEO, CFO, Board Secretary and Chairman should keep a list of these required approvals handy to ensure that they are placed on the Agenda and approved by the Board promptly.

4. Maintain files of Upcoming Board Event and Issues

Each of the Board Secretary, CFO (if a different person), CEO, and Chairman, should maintain a continuous file into which they put notes of items that likely will require a report or approval by a Committee or the Board. This will include those items defined in the Shareholders Agreement,

and may include other items that management believes should be brought to the Board or Committee.

The Board Secretary has the responsibility of monitoring the calendars for the Board and Committees which will also identify issues for upcoming meetings.

#### 5. Management Planning Meeting – Two weeks prior to Board Meeting

The Board Secretary should call a meeting with the CEO and CFO at least two weeks prior to the next Board meeting. Prior to the meeting, the CEO should contact the Chairman and inquire if there are any items that the Chairman would like to put on the Board agenda.

At the management planning meeting, management will refer to their continuous files to identify items that will be on the agenda for the upcoming meeting. The Secretary will then prepare a first draft of the Board Agenda, including the agenda items, decision items, and the person responsible for preparing the report to the Board.

#### 6. Circulate Agenda to Management

The Board Secretary should circulate the draft Agenda as soon as the Agenda is drafted to everyone who will prepare a report. Please see related document [Sample Board Agenda](#). Reports must be in near-final form one week prior to the meeting. The Secretary should monitor the preparation of the reports and the CEO should expedite late reports.

#### 7. Management Review Meeting – One week prior to Board Meeting

The Board Secretary should assemble a 3-ring or electronic binder containing all of the reports to the Board at least one week before the meeting. The Secretary and CEO should review the reports for completeness, accuracy, tone, and to see if all of the decisions the Board must make have been identified. Other management team members may or should attend this meeting, as time and priorities dictate.

#### 8. Prepare binders and circulate to Board – 5 working days before Board Meeting

- 8.1 Legal Requirements – Formal Notice of Meeting. There are legal requirements to be met in the calling of a Board meeting. To call a meeting is to establish a date, time and place at which the meeting is to be held. To be properly convened a meeting of directors must be called by proper notice given by a person duly authorized to do so. The bylaws of the corporation typically provide that meetings of directors may be called by the president, secretary or another member of the board. The calling of meetings is normally one of the secretary's functions. By-laws also typically provide that a meeting may not be called on less than 24 or 48 hours formal Notice. A valid notice of meeting will contain the date, time and place of the meeting, the purpose of the meeting and notice of any special business to be conducted. The notice must be delivered to all directors in the manner set forth in the by-laws. The Notice is

typically the lead item in the Board Agenda which also includes the special business to be conducted. Please see related document [Sample Board Agenda](#).

8.2 Legal Requirements – Sufficiency of Information. A director is entitled to receive sufficient information respecting every decision to be made by the board in order to permit the director to make intelligent and informed decisions. The board will typically provide guidance to management of the type of materials required and the manner of preparation. Please see related document [Board Terms of Reference](#).

The formal Notice and the information for directors is usually included in binders to be sent to the Board at least 5 days in advance of the meeting either in a physical 3-ring binder, or in electronic format.

8.3 Legal Review. Some Board items should be reviewed by legal counsel. Please see related document [Legal Review](#).

8.4 Board Binders.

If the binders are prepared physically, the Agenda should be placed at the front, and each agenda item separated by a numbered tab divider. A popular method to circulate materials is for a materials binder to be prepared properly cross-referenced to agenda items.

Decision items should be clearly identified. A directors' package may include:

- the notice and/ or agenda for the meeting;
- draft minutes of previous meetings to be approved;
- draft resolutions for matters to be discussed at the meeting. Resolutions circulated in advance will clarify the precise subject matter, facilitate discussion and simplify the preparation of minutes;
- draft financial statements and other financial reports;
- draft agreements and other documents to be approved;
- draft press releases; and
- memoranda describing proposed transactions to be approved.

If the binders are electronic, most Board members will want to print them out in any event. To assist the directors, the files should be given a number and name corresponding to the Agenda item, e.g. "1. Minutes of Previous Meeting", "3. CEO Report", etc. This way, they will be more easily organized after a mass of documents have printed and reconciled to the agenda.

9. Chairman and CEO review meeting – at least one day prior to Board Meeting

The Chairman and CEO should review the agenda and binder of materials briefly at least a day prior to the meeting. This will alert the Chairman to the significant issues and updates to help him manage the meeting.

10. Post Meeting – Minutes within 48 hours

Typically minutes are left to just before the next Board meeting. However, Directors should review the minutes while the meeting is still fresh in their minds. There may be action items for Directors to be acted on quickly. For these reasons, the Board Secretary should prepare the minutes and review with the CEO and Chair within 48 hours, and circulate to Directors within one week of the meeting.

#### 11. Stumbling Blocks – Why Doesn't the Process Go Smoothly?

As indicated above, even in the best performing companies, the organization and preparation of Board meetings falls far short of an acceptable standard. Too often, there is a tense scramble at the last minute to write the reports, assemble the binders and distribute them on time. The packages are often late and incomplete, and Directors do not have sufficient time to read, digest, and question the material prior to the Board meeting.

The fault for this failure usually lies with the CEO. As the decision-maker of last resort, the CEO works long, hard days, and the urgent matters often take precedence over the important. Often a heavy travel schedule removes the CEO during the preparation period. The CEO's report, and the review of the agenda and draft documents is left too late to avoid the scramble to complete.

Regrettably, there is no solution to this problem. Even with weeks of notice, established timelines, and constant follow-up from the Board Secretary, if the CEO will not assign a high priority to the timely preparation and review of the Board materials, then the planning goes for naught. Admonishment from the Chairman and other Directors may help the CEO to pay due attention to the preparation process and timelines.

## 4.1 Sample Board Agenda

ABC Start-Up Co. Inc.  
Boardroom, Company Offices  
Day, Date, and Time

### NOTICE OF DIRECTORS' MEETING

A meeting of the Directors of ABC Start-Up CO. Inc. will be held at \_\_\_\_\_ a.m./p.m. local time on the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ at the following location:

\_\_\_\_\_

Vancouver, British Columbia

### MEETING AGENDA

I – x: Information item

D – x: Decision item

#	Tab	Item	Responsible
1		Call to Order	Chairman
2		Waiver of Notice	Chairman
3	D – 1	Minutes of Previous Meetings	Secretary
4		Business Arising from the Minutes	Chairman
5	I – 1	CEO's Report	CEO
6	I – 2	CFO's Report	CFO
1	D – 2	Approval of Financial Statements	Chairman
7	I – 3	Certificate of Compliance	CFO
8	I – 4	Sales Report	VP Sales
9	I – 5	Development Report	VP R&D / CTO
5	I – 1	Quarterly Operations Report	CEO
6	I – 2	- Financial Report	CFO
1	D – 2	- Approval of Financial Statements	Chairman
7	I – 3	Certificate of Compliance	CFO

8	I-4	- Sales Report	VP Sales
9	I-5	- Development Report	VP R&D / CTO
10	I-6	- Administrative Report	CEO / CFO
11	I-6	Audit Committee Report	Audit Chair
12		Items Requiring Board Approval	Chairman
	D-3	- Options grant	
	D-4	- Hiring of Senior Executive	
	D-5	- Major Contract	
13		Other Business	Chairman
14		Next Meeting	Secretary
15		Adjournment	Chairman

Notes:

- Items 5 through 9 in teal are items on the agenda for the regular monthly Board meetings.
- Items 5 through 9 in pink form the Quarterly Report to the Board on the Annual Operating Plan, and replace for this quarterly meeting the corresponding items 5 through 9 in blue.

## 4.2 Who Should Attend Board Meetings

In addition to the Directors, who else should attend Board meetings?

- The Board Secretary must be present to take and present the minutes. Typically, the Secretary is also the Chief Financial Officer.
- The CFO should present the Financial Report. It is prescribed in large public companies that the CFO and CEO personally attest to the accuracy of the financial statements and controls. While this does not apply in early-stage tech start-ups, it is good practice for the CFO to take ownership for the numbers to the Board.

There is a second reason for the CFO to attend Board meetings. As the depth of oversight continues to increase, an area that is receiving more attention is risk assessment and risk management. Inevitably, this task will devolve to the CFO. He will then be responsible for identifying the sources of risk and developing plans to mitigate them. The Board may wish to hear and question a report on risk from the CFO from time to time. Please see related document [Risk Assessment](#).

- Officers. Anyone who is an Officer of the company should also attend Board meetings. Invariably, these are senior executives and perhaps founders who have a depth of knowledge which the Board would wish to have present at the meetings. Importantly, because Officers carry the same liability as Directors, they should be present when the decisions are made which impact that liability.
- Other C-level Executives. There is a difference of opinion on whether all C-level executives (Chief Technical Officer, Chief Marketing Officer, etc.) should attend. The argument against their attendance is that the CEO is ultimately responsible for management and all reporting and review should be centralized through him or her. The counter argument is that the Board has a fiduciary duty to avail themselves of all important information and receiving reports directly from the senior executives follows from this. In addition, there is educational value for younger executives in preparing, delivering and answering questions on reports directly to the Board. At meetings where management presents quarterly reports on the Operations Plan to the Board, the other C-level executives should present the reports from their respective functional areas. Please see related document [Sample Board Agenda](#).

On balance, the arguments in favour of attendance are stronger, and most companies encourage all senior executives to attend Board meetings. However, in terms of conduct at meetings, the Board meeting belongs to the Directors. Management is there to report and answer questions, but not to debate either the CEO or the Directors, unless expressly asked to.

See the related topic [Organizing a Board Meeting](#).

### **4.3 Meetings of Independent Directors**

In large companies, it is standard governance that the independent directors meet regularly separately from management directors. The CEO, as management, would not join these meetings.

Even in early-stage technology companies, independent directors should meet to ensure that the company is seen to be receiving oversight and guidance by a group entirely independent of management. It should be documented in the Company's Board manual that the Board has the right and responsibility to hold meetings of its independent directors.

Typically, for convenience, the independent directors would meet just prior to a regular Board meeting, unless there was an important issue that required an extraordinary meeting. By definition, the Chairman would need to organize the meeting without the usual help of the Board secretary.

In a regularly scheduled independent meeting, directors discuss in general terms the work of the committees and the Board. They may air issues that might be resolved without resort to a minuted Board discussion. One theme would be the openness and responsiveness of management to the Board.

Any review of executive compensation must be done in an independent directors meeting.

One or more of the independent directors may request an extraordinary meeting of the independent directors to hold management to account if he or they reasonably believe that

#### **4.4 Frequency of Board Meetings**

For early stage technology companies, Board meetings should be held monthly. With the rapid change of business issues, and the need of management for regular guidance, meetings need to be held monthly to keep Directors informed and to provide timely guidance to management.

At least every quarter, the Board should receive a full update or Operations Review from management on the annual Operating Plan and Budget. Please see related document [Sample Board Agenda](#).

Some very early stage companies have weekly Board meetings. Some inexperienced management teams may require this level of review to avoid ill-considered decisions. However, if the Board is meeting weekly, it is effectively reviewing every decision, and is de facto a part of senior management. Arguably, this is more control than a Board should exercise.

As the company matures, and management gains experience, the Board can relax its frequency to six weeks, of which every second meeting could be a teleconference. Eventually, in mature companies, quarterly meetings is the norm.

#### 4.5 Physical Presence or Teleconference

In the 21st century, particularly for technology companies, it would seem that Board meetings could effectively be held by teleconference, using Skype, GoToMeeting, or other online communication tools. This would allow Directors to be appointed irrespective of geography, and eliminate the expense of travel for the cash-strapped company, and the time wasted in travel for the directors.

However, Boards that meet only by teleconference are less effective. First, the directors cannot develop the personal relationships over the phone which are important for building trust and reliance. In times of stress, the personal trust may be critical for resolving difficult issues.

Second, directors participating in Board meetings by phone cannot "read the room", and see the physical and emotional reactions to information and events during the meeting. They are relying solely on what they can hear over the phone. Often, the acoustics in conference calls are poor, particularly if there is a lot of paper-shuffling, or the noise of a projector. Further, they are more easily distracted by events around them in their remote location. In sum, directors on the phone are not as engaged as directors in the room, and this negatively affects the quality of the meeting.

For these reasons, teleconference Board meetings are effective only when the matters are routine and the decisions easy to reach. When the issues are difficult, and the Board must integrate their collective wisdom, a teleconference call significantly impairs the discussion, just when it is needed the most.

The earlier and less mature the company, the stronger the argument to appoint local directors who can be physically present at meetings, and are more readily available to the company.

Many companies holding monthly Board meetings make every third or quarterly meeting an on-site meeting with all directors present. Directors can meet informally over dinner and have meeting independent of management in addition to the formal Board meeting.

The need for Directors to meet in person, frequently if not at each Board meeting, is essential preparation for when problems arrive. As noted in the accompanying article [6.3 Directors Need to be on Common Ground](#), in times of crisis when quick response is needed, directors need to have built trust with each other to feel confident in the advice they give. If the Directors don't know and trust each other, it will be difficult for the Board to advice on difficult issues.

## 4.6 Philosophy of Board Meeting Minutes

Minutes are the records of the proceedings of a meeting. A corporation is required under corporate legislation to prepare and maintain minutes of meetings and resolutions of directors, committees of directors and shareholders. Minutes are typically prepared by the Secretary of the corporation or the person designated as secretary at a particular meeting.

Accurate minutes avoid future misunderstandings, serve as guides in implementing decisions taken at meetings and provide a written record for evidentiary purposes.

### 1. Content of Minutes

Minutes should commence with the name of the corporation and give the type of meeting (e.g. directors or audit committee). The minutes should also record the date, time and place of the meeting and the persons in attendance at the meeting and the manner of attendance (e.g. in person, by telephone, or by video conference). Please see related document [Sample Board Meeting Minutes](#).

Minutes should be written in the past tense (eg. "The Chairman advised the Meeting that ....") to record events at the meeting and in the past perfect tense to record events prior to the meeting (eg. "The Chairman reported that he had completed his survey ....").

Corporate legislation provides little guidance on the content of minutes. There are two schools of thought with respect to minute keeping: the "bare-bones" type with little narrative and the more informative narrative style.

There is a clear choice for "bare-bones" approach. In this approach, the minutes briefly indicate:

- The nature of the issue,
- That a "brief" or "full" discussion ensued, and
- Any motion that was adopted as a result of the discussion.

For example, the Board might have a vigorous discussion about a matter of company policy, with different and conflicting viewpoints articulated. Eventually the Board might come to a decision and adopt a course of action. The minutes should read: "The Board reviewed the company policy with respect to x. A full discussion ensued. ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT the following course of action be adopted: xxx".

A narrative approach to minutes would provide a more complete record of the discussion and perhaps demonstrate that the Directors exercised their fiduciary duty by fully exploring the options before deciding on a course of action. The argument against this approach is the absence of discussion on a particular consequence or motivation might indicate a lack of full consideration and thereby expose the directors to action from a disgruntled shareholder. The more that is documented, the greater the opportunity to find fault.

For this reason, the discussion of particular questions or alternative actions considered at a meeting but not authorized normally does not form part of the minutes. That said, there may be some instances where the alternative courses of actions should be included to protect the participants if their conduct is later questioned.

A director, however, may specifically request that the person's view be made part of the record if he or she feels strongly that their stated position be part of the official record.

Minutes should also include reference to specific instructions given by the board to officers or other employees of the corporation.

It is not necessary that the names or person who propose or second resolutions be recorded. Indeed to do so may be misleading: To move or second a motion implies support. However, a Director may move or second a motion only to ensure discussion and may vote against it later. It is also not necessary in most instances for the names of the persons voting in favour of resolutions to be recorded, unless this information is required by statute, regulatory authorities or a director requests that the director's dissent be recorded in the minutes.

A report records what is said at a meeting while minutes set out only the resolutions and decisions taken. A report made to the meeting is normally only referred to and not set out in full in the minutes. The secretary should maintain a file of documents or reports for each meeting. A simple notation in the minutes indicating that the document or report was submitted is normally sufficient.

## 2. Right to Dissent

Corporate legislation permits directors to register their dissent if they are not in agreement with certain actions taken by the corporation. A dissenting Director is exonerated from potential liability that might arise by reason of contravention of corporate statute. A Director wishing to register dissent must announce at the meeting that the director wishes the secretary to have the minutes record opposition to a resolution and the reasons for the opposition. Dissent rights are not available if the director votes for or consents to the resolution. Merely voting against a resolution is not sufficient to exercise a right of dissent; a director absent from a meeting is deemed to have consented to business approved at the meeting unless the director within seven days of learning of the business advises the corporation of the director's dissent.

## 3. Disclosure of Conflicts.

A Director or Officer who is a party to a material contract or transaction with the corporation must disclose the nature and extent of their interest and have the minutes must reflect the disclosure. Subject to certain exceptions, a conflicted director may not vote on the contract. Exceptions include contracts relating primarily to remuneration as a director, officer or employee of the corporation, and contracts for indemnity and insurance of the directors.

#### 4. Approval of Minutes

Minutes or previous meetings are commonly circulated in advance of and approved at a meeting, however, there is no legal requirements to approve minutes of a meeting at a subsequent meeting. The minutes should be carefully reviewed by the participants in the meeting to ensure that the minutes accurately reflect what transpired at the previous meeting. The approval of the minutes at a subsequent meeting is the approval of the minutes as a true record of the proceedings at the previous meeting, not the approval of the proceedings themselves. The failure to approve minutes does not invalidate the minutes.

The Chair and the Secretary normally sign the minutes, and the signed copy kept in the Corporate Minute Book.

#### 5. Disclosure of Board Minutes

Secretaries and Directors need to remember that minutes are a permanent part of the corporate record and may be read by many people long into the future. For example, the company's auditors read the minutes as part of their annual audit or review. Also, a professional investor contemplating an investment or a company pursuing a merger or acquisition will read the minutes as part of their diligence on the company. With this in mind, the Secretary should use discretion in writing the minutes. For example, if the CFO reported that a financial transaction was being hampered by the reticence of a potential investor, it would be embarrassing for the a close colleague of that investor to subsequently read this disclosure in the minutes.

Apart from the minutes, Board deliberations are confidential<sup>1</sup>. This allows the Directors to be completely forthcoming in all deliberations, as there is no record of their contributions unless the Director specifically requests it.

However, if the company or Board are being sued, then all deliberations can be brought to the surface in the process of discovery. On examination for discovery, the minutes, the directors' personal notes, and even the otherwise confidential oral Board discussions are all fair game. Some companies request directors to destroy their notes immediately after a meeting to avoid contradictory records should they become part of a discovery, but nonetheless, the oral deliberations are also discoverable<sup>1</sup>.

In sum, apart from a litigation, the Board minutes are the only documentation that can be reviewed. Bare-bones minutes leave the minimum basis for later recriminations.

Remember, however, that a Director's best protection is the integrity of his deliberations and actions. Provided that he exercises a reasonable amount of care and diligence relative to his experience and training, and acts reasonably with the best interests of the company in mind, a Director should be protected, whatever appears in Board minutes, or is discussed at Board meetings and in-camera sessions.

<sup>1</sup>There is an exception when conflicts are disclosed in the minutes: a shareholder has a right to see that written portion of a Board meeting or resolution where a conflict is disclosed by a Director.

<sup>2</sup>Legal advice given with respect to the litigation is not discoverable as it is protected by solicitor client privilege.

**4.6.1 SAMPLE BOARD MEETING MINUTES**

**ABC COMPANY**  
**MINUTES OF MEETING OF THE BOARD OF DIRECTORS**  
**<<DATE>>**

A sample of minutes to record various decisions that Boards make from time to time is included below.

●  
(the “Corporation”)

MINUTES OF A MEETING of the Board of Directors of the Corporation held on the  
●, at ● a.m./p.m. at ●, British Columbia

---

**PRESENT:**

- 
- 
- 

**PRESENT BY TELEPHONE:**

- 
- 

**PRESENT BY INVITATION:**

- 
- 

**A. Declaration of the Chairman**

Notice of the meeting having been given to all directors of the Corporation, the Board asked ● to act as Chairman of the meeting. At the request of the meeting, ● acted as Secretary.

**B. Quorum**

The Chairman noted that a quorum of the Board of Directors was present, that all directors had received proper notice and declared the Meeting open for the transaction of business at x:xx PM.

●

C. ● *[First Item of Business]*

●

D. Approval of Agenda

●

E. Minutes of Previous Meeting of Directors

The Chairman tabled the minutes of the meeting of directors held on ●

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT the minutes of the meeting of directors held on ● be approved (as amended).

F. Appointment of Officers

*[Note: This resolution is for the annual confirmation and appointment of officers. Officers include those persons who hold the following positions: President, Secretary, Chairman, Vice-Chairman, Managing Director, Vice-President, Treasurer, Assistant Treasurer. Additional positions of office may be created by the Board. A company need not have officers for all the positions indicated above, but must have a President and Secretary.]*

The Chairman advised that it was appropriate for the Corporation to appoint officers for the ensuing year.

Upon motion duly moved, seconded and carried it was resolved that:

1. The following persons be appointed to hold the office set forth opposite their names below:

Name	Office
	President
	Secretary

2. Subject to the terms /● - appoint as officer ; and
3. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

G. Appointment of ●

*[Note: This resolution is for the employment and appointment of a new officer.]*

The Chairman advised that the Corporation proposed to hire ● and appoint him/her as the Corporation's ●. He circulated to the meeting a copy of a draft employment agreement and summarized for the meeting the proposed terms of employment.

Upon motion duly moved, seconded and carried it was resolved that:

1. the Corporation enter into an employment agreement with ● (the "Employment Agreement") under which ● would be employed as the Corporation's ● on the terms and conditions contained in the draft agreement dated ● presented to the board with such amendments and variations, if any, as the person(s) executing the Employment Agreement may approve, such approval to be conclusively evidenced by the execution of the agreement and such execution shall be conclusive evidence that the agreement so executed is the Employment Agreement authorized by this resolution.
2. ● - appoint as officer ; and
3. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

#### **H. Resignation of Director**

The Chairman advised that the Corporation had received a resignation as director from ● dated ◆, 2001.

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. the resignation of ● as director of the Corporation dated ● be hereby accepted effective immediately; and
2. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

#### **I. Appointment of New Director to Fill Vacancy**

*[Note: This resolution is for the appointment of a director to fill the vacancy on the board created by the resignation of another director. If the size of the board is to be increased between annual general meetings so that additional directors may be added legal counsel should be consulted.]*

The Chairman advised that following the resignation of ● a vacancy existed on the board. ● recommended to the meeting that ● be appointed as a director to fill the vacancy until the next Annual General Meeting of the Corporation or until his successor is elected or appointed. ● further advised that ● had delivered to the Corporation a written consent to act as director.

Upon motion duly moved, seconded and carried it was resolved that:

1. consent in writing having been received by the Corporation, ● is hereby elected as a director of the Corporation to act as such until the next Annual General Meeting of the Corporation or until his successor is elected or appointed, subject to the Corporation's Articles; and
2. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**J. Creation of Audit Committee**

The Chairman advised that the Corporation wished to create an Audit Committee to oversee the financial reporting and controls of the Corporation. ● circulated to the meeting a draft mandate of the Audit Committee.

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. an Audit Committee of the Board of Directors be formed with the powers set forth in the document headed "Mandate of the Audit Committee" presented to the Board of Directors (a of which is attached as Schedule "A" to these minutes);
2. the following persons be elected as members of the Audit Committee to hold office effective as of the date of this resolution:
  - ;
  - ; and
  -
3. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**K. Creation Of Compensation Committee**

The Chairman explained that it was appropriate to create a Compensation Committee. ● circulated to the meeting a mandate of the Compensation Committee.

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. an Compensation Committee of the Board of Directors be formed with the powers set forth in the document headed "Mandate of the Compensation Committee" presented to the Board of Directors (a copy of which is attached as Schedule "B" to these minutes);
2. the following persons be elected as members of the Compensation Committee to hold office effective as of the date of this resolution:

- ;
- ; and
- 

3. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**L. Banking Resolutions**

● explained to the meeting that the Corporations' bank had requested the Corporation pass a banking resolution in the bank's standard form. ● circulated to the meeting standard form resolutions of the ● Bank.

Following discussion it was agreed that the signing officers of any bank account of the Corporation would be:

- (i) ●; or
- (ii) ●.

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. the ● Bank (the "Bank") be and is hereby approved as a bank of the Corporation;
2. the form of banking resolution required by the Bank, in the form attached hereto as Schedule "C" (the "Banking Resolution"), is hereby adopted and approved;
3. the Banking Resolution , together with all other banking documents required by the Bank, be executed and the seal of the Corporation affixed where required in the presence of the President or Secretary;
4. any officer or director is authorized for the Corporation and on the Corporation's behalf to make such affidavits or to sign and file such financing statements or other documents as may be required for the registration or filing of bills of sale, chattel mortgages, assignments of book of debts, conditional sales contracts, claims for mechanics' liens and construction liens or for the perfection of the Corporation's security interest in any personal property and to renew chattel mortgages, assignments of book debts and conditional sales contracts or to sign and file financing change statements and for the purposes aforesaid each and every of such officers and directors is given full power and authority to perform and execute all acts, deeds, matters and things necessary to be done in the premises; and

any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution;

5. The CEO, CFO, Controller, and CTO be authorized to sign cheques on the Company's bank account; and
6. All cheques must be signed by at least two authorized signatories.

**M. Appointment of Member of Audit Committee to Fill Vacancy**

*[Note: This resolution is for the appointment of a member of a committee to fill the vacancy created by the resignation of another member. Resolution ● should be used for the annual appointment of members to the committee.]*

● advised the meeting that as a result of the resignation of ●, the ● Committee was comprised of only ● members; ● and ●. The Chairman recommended that ● be elected as an additional member of the ● Committee to fill the vacancy.

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. ● be elected as a member of the ● Committee to hold office effective as of the date of this resolution; and
2. any one or more of the directors and officers of the Corporation be and is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**N. Grant of Stock Options**

*[Note: This resolution assumes the Corporation has a stock option plan and that all options are granted in compliance with the terms of the plan. The terms of the plan should be reviewed prior to any stock option grant to ensure that a sufficient number of options are available for grant and that the price, expiry date, and vesting terms are consistent with the plan. If the Corporation does not have a stock option plan, legal counsel should be consulted prior to the grant of any stock options.]*

The Chairman advise the meeting that it is in the best interests of the Corporation to grant stock options to certain directors, officers, employees and consultants of the Corporation under the terms of the Corporation's stock option plan dated ● (the "Plan").

Following discussion, ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. Subject to any necessary regulatory approval, the following stock options (the "Options") to purchase up to that number of common shares in the capital of the Corporation (the "Shares") set opposite the names below (the "Option Holders") be granted to the Option Holders subject to the terms and conditions of the Plan:

Option Holder	Date of Grant	Number of Shares	Exercise Price	Expiry Date	Vesting


**O. Financial Statements for the Year Ended ●**

*[Note: The audit committee has responsibility for reviewing the year end financial statements with the auditors and recommending to the board that the statements be approved. A separate meeting of the Audit Committee should to approve the financial statements and submission of the statements to the board for approval. The introduction assumes that a representative of the auditors is present at the board meeting to answer additional questions.]*

● reported to the meeting on the Corporation’s financial statements for the year ended that had been delivered to the Board as part of the directors’ material for the meeting. A report was also provide to the board by ● of ●, the Corporation’s auditors. ● advised that the Audit Committee had reviewed the financial statements and recommended to the Board that the statements be approved.

IT IS HEREBY RESOLVED THAT:

1. the financial statements of the Corporation for its fiscal year ended ●, together with the Auditor’s Report thereon and the notes thereto be adopted and approved;
2. any two directors of the Corporation are hereby authorized and directed to sign the balance sheet forming a part of the financial statements on behalf of the directors to evidence the approval of the directors; and
3. any one director or senior officer of the Corporation be and he is hereby authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation if applicable, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**P. Financial Statements for the Quarter Ended ●**

*[Note: The mandate of the Audit Committee may include the responsibility to review interim financial statements. The introduction to the following resolution assumes that the board has granted to the Audit Committee this responsibility and that the Audit Committee has held a separate meeting to approve the interim financial statements.]*

● reported to the meeting on the Corporation’s financial statements for the ● month period ended ● that had been delivered to the board as part of the directors’ material for the meeting. He advised that the Audit Committee had reviewed the financial statements and recommended to the board that the statements be approved.

Following discussion, UPON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT:

1. the financial statements of the Corporation for the ● months ended ● be and they are hereby approved; and
2. any one or more directors or officers of the Corporation are authorized and directed to perform all such acts, deeds, things and execute under the seal of the Corporation or

otherwise such documents and other writings, including treasury orders, as may be required to give effect to the true intent of this resolution.

**Q. Budget for the Fiscal Year ended ●**

● delivered a report relating to the budget for the fiscal year ended ● that had been delivered to the board as part of the directors' materials for the meeting

Following discussion UPON MOTION DULY MADE, SECONDED AND CARRIED IT WAS RESOLVED THAT:

1. the budget for the fiscal year ended ● presented to the board be approved; and

**R. Approval of ● Agreement**

*[Note: This resolution relates to the approval of an agreement in draft form and authorizes further changes to the agreement that may be required before the agreement is signed. The board may wish to specify in further detail who may execute the agreement or the extent of amendments that may be made to the agreement (e.g. limit on purchase price). Resolutions relating to the approval of agreements should be vetted by legal counsel. This is particularly important if legal counsel will be required to provide an opinion relating to the agreement.]*

● advised the meeting of the proposed transaction with ● relating to ●. He then reviewed the ● agreement that the Corporation proposed to enter into relating to the transaction, a copy of which had been included as part of the directors' materials for the meeting.

Following discussion UPON MOTION DULY MADE, SECONDED AND CARRIED IT WAS RESOLVED THAT:

1. the Corporation enter into an agreement providing for ● (the "● Agreement") relating to ● on the terms and conditions contained in the draft agreement dated ● presented to the board with such amendments and variations, if any, as the person(s) executing the ● Agreement may approve, such approval to be conclusively evidenced by the execution of the agreement and such execution shall be conclusive evidence that the agreement so executed is the ● Agreement authorized by this resolution.
2. any one or more of the directors and officers of the Corporation are authorized to execute and deliver the ● Agreement in the name and on behalf of the Corporation under its corporate seal or otherwise; and
3. any one or more of the directors and officers of the Corporation be authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**S. Ratification of ● Agreement**

*[Note: This resolution relates to the ratification of an executed agreement. As a general practice management should avoid executing agreements that are expected or required to be approved by the board in advance of board approval. Resolutions relating to the approval of agreements should be vetted by legal counsel. This is particularly important if legal counsel will be required to provide an opinion relating to the agreement.]*

● advised the meeting of that the Corporation had executed a ● agreement dated ● with ● relating to ●. He then reviewed the ● agreement, a copy of which had been included as part of

the directors' materials for the meeting and requested the board ratify the execution of the agreement.

Following discussion UPON MOTION DULY MADE, SECONDED AND CARRIED IT WAS RESOLVED THAT:

1. the ● [*Describe transaction*] by the Corporation on the terms and conditions contained in the ● agreement (the “● Agreement”) dated ● between the Corporation and ● presented to the board is approved, ratified and confirmed and the execution and delivery of the ● Agreement in the name and on behalf of the Corporation by ● is approved, ratified and confirmed;
2. any one or more of the directors and officers of the Corporation are authorized to execute and deliver the ● Agreement in the name and on behalf of the Corporation under its corporate seal or otherwise; and
3. any one or more of the directors and officers of the Corporation be authorized and directed to perform all such acts, deeds and things and execute, under the seal of the Corporation or otherwise, all such documents and other writings as may be required to give effect to the true intent of this resolution.

**T. Termination of Meeting**

There being no further business, ON MOTION DULY MADE, SECONDED AND CARRIED, the meeting was adjourned.

---

●  
Chairman

---

●  
Secretary

## 4.7 CEO REPORT TO BOARD TEMPLATE

The following is a template for the CEO's Report to the Board which is the most important part of every Board package and the focus of every Board meeting.

[Company]

**CEO Update**

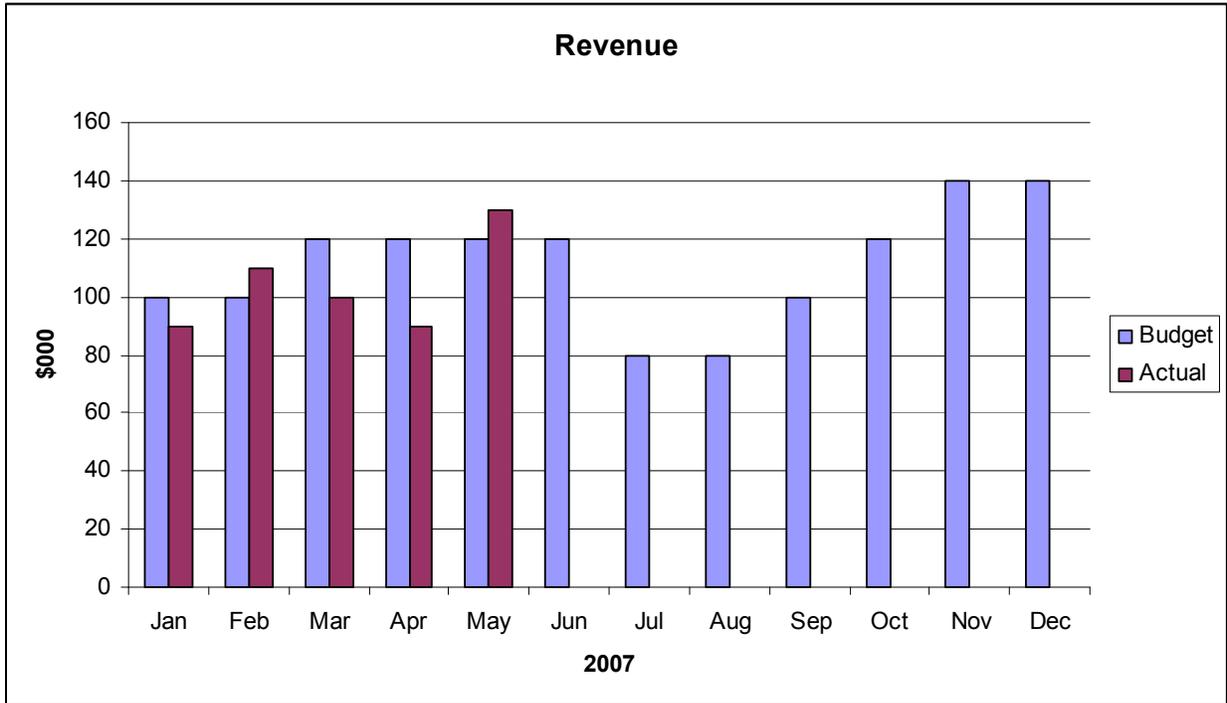
Month, year

This is the CEO Report to the Board for [full company name] for [the month, year].

### Dashboard

Revenue	↑	
EBIT	↗	
Sales Pipeline		→
New Customers	↓	
Runway	→	

[The Dashboard provides a snapshot summary of the key operating parameters for the Company's business. Some parameters (especially Runway) are common to all technology businesses whereas other parameters may reflect different parameters material to that point in the Company's development. For example, a company still in development mode would report on the status of development rather than revenue.]



Each of the items below should consist of one to two paragraphs.

**Highlights and Red Flags**

At the top of the update, succinctly describe both the good and the bad news from the previous month.

**Summary Financial Results Compared to Budget for Month, Year to Date**

	Month			Year to Date		
	Actual	Budget	Var	Actual	Budget	Var
Revenue						
Expenses						
Net Income						
Cash						
Working Capital						
Runway (days)						

The reasons for these variances are \_\_\_\_\_.

Please see detailed financial results in CFO Report to the Board.

### **Research and Development**

Discuss how the actual work is proceeding to plan and explain any variances. Summarize material problems that have been encountered that are currently outstanding, and what is being done to address them.

Include a table which compares the progress of each R&D project relative to its budget and schedule, as shown below:

<b>Project</b>	<b>% Complete</b>	<b>% Budget Expended</b>	<b>Days Ahead / (Behind)</b>
Project 1			
Project 2			
Project 3			

### **Sales and Marketing**

A short sales report that describes the funnel, how it is being filled, how it is being managed, the expected closure rate and date etc. If, in any prior reports, sales were projected to close and they have fallen off the table, identify and explain what happened.

### **Strategic Relationships**

Discuss any discussions, progress etc. in relation to strategic partners.

### **Human Resources**

Discuss significant additions to/deletions from the team over the past month and the total number of hires and losses. If the budget projected a new hire in that month and the position hasn't been filled, discuss. Identify what positions are needed to be filled. If the Company is at risk regarding a position, please identify. Identify additions/deletions to the Board and Advisory Board as well.

### **Financing**

Discuss the status of your financing plans. Also advise if the Company has been approached by any financiers.

This should be discussed in greater detail in the CFO Report to the Board.

### **Mergers and Acquisitions**

Discuss any approaches that have been made by potential buyers, or if the Company has identified any acquisition opportunities.

### **Heads Up**

Discuss any material item that may come up in the next 90 days that we should be aware of.

The foregoing is, to the best of my knowledge, true and accurate.

[Your name in text]

CEO

#### 4.8 SAMPLE CFO REPORT TO THE BOARD

The following is a template for the Report of the Chief Financial Officer to the Board. It summarizes the Company's current financial position and financing plans.

[Company]

CFO Update

Month, year

#### Financial Results Compared to Budget for Month and Year to Date

Summary Income Statement

	Month			Year to Date		
	Actual	Budget	Variance \$	Actual	Budget	Variance \$
<b>Revenue</b>						
Product 1						
Product 2						
<b>Total Revenue</b>						
<b>Expenses</b>						
<b>R&amp;D</b>						
Payroll						
Materials						
Misc. exp.						
<b>Total R&amp;D</b>						
<b>Sales &amp; Marketing</b>						
Payroll						
Travel						
Collateral						
Trade Shows						
Website						
Misc. exp.						
<b>Total Sales &amp; Marketing</b>						
<b>G&amp;A</b>						
Payroll						
Rent						
Office Expenses						
<b>Total G&amp;A</b>						
<b>Total Expenses</b>						
<b>Net Income</b>						

Note that some company's also like to see a quarter to date variance report which provides more granularity.

**Summary Balance Sheet**

**Month, Year**

	<b>Actual</b>	<b>Budget</b>	<b>Variance</b>
Cash			
Accounts Receivable			
Other current assets			
<b>Total Current Assets</b>			
Capital Equipment			
Other Assets			
<b>Total Assets</b>			
Bank Line			
Account Payable			
Other current liabilities			
<b>Total Current Liabilities</b>			
Long-term debt			
Capital Stock			
Retained Earnings/(Deficit)			
<b>Total Sh. Equity</b>			
<b>Total Liab &amp; Sh.Eq</b>			

**Summary Cash Flow**

	Month			Year to Date		
	Actual	Budget	Variance \$	Actual	Budget	Variance \$
<b>Net Income</b>						
Non-cash Items						
<b>Cash Flow from Operations</b>						
<b>Capital Purchases</b>						
<b>Financing Activities</b>						
<b>Increase in cash flow</b>						
Beginning cash						
Ending cash						

**Analysis of variance**

The CFO should include a paragraph or two highlighting the reasons for the variances to budget, and management’s response. The analysis should inform the directors for the underlying business reasons for the variances, rather than drily reciting the numbers in the tables. For example, “Revenues exceeded budget because of the trend towards xxx which has increased the demand for the company’s products. Cash reserves are \$xx below target because accounts receivables have increased to xx days. Several customers are now exceeding 60 days. The CFO and VP Sales have expedited payment with senior management.”

**Runway (Cash Position)**

The Company's current working capital position is \$\*, including accounts receivable of \$\* (also expressed in days) and payables of \$\* (and days). The Company's cash position at month end was \$\*. The Company's current burn rate is \$\*. Assuming we hit our targets the Company has sufficient cash to fund operations until \*[date] which is a runway of \_days.

**Forecast Financial Results**

It is a basic requirement for companies to produce variance reports against budget for the year to date. However, it is even more useful to directors to have a picture of how the balance of the year and the next 4 quarters will unfold both for the financial statements (profit and loss, and balance sheet) and cashflow. Arguably, the accurate prediction of the cash balance into the future is the single most important job of the finance team and CFO. It is critical in planning all company operations, future financings, etc. However, it is a difficult task, fraught with error. It requires the merging of the current financial performance with a predictive model which is challenging. Typically, standard accounting packages for small companies do not have this capability. The CFO must resort to an Excel model which provides the flexibility required, but which can imbed significant model errors which can escape discovery.

Software companies which earn licence, professional services and maintenance revenue have even a more complex task to predict cashflow. They may be paid in installments, but recognize revenue as work is completed. Maintenance contracts are paid annually in advance which gives

rise to deferred revenues and an amortization schedule. Factoring all these parameters into a comprehensive projection model is a tall order which few companies attempt. Most rely on the summary runway calculation presented above.

Companies with the experience and cycles to develop a cashflow projection can prepare a report with the following headings, and the financial statement entries shown above. “act+proj” is short for “actual plus projected” which is the actual results year to date combined with the forecast for the balance of the year, or the next 4 quarters.

Month: Jun-10			Year to date: 2010			Forecast year end 2010			Forecast 4 qtr: Q2'10 - Q1'11		
actual	budget	variance	actual	budget	variance	act+proj	budget	variance	act+proj	budget	variance

### Financing

Discuss the status of your financing plans. Also advise if the Company has been approached by any financiers.

### Capital Structure

If there have been any changes to the share capitalization (other than regular vesting of employee and director shares or options), present an updated share cap table, as follows.

Shareholder	Number of shares	% of Issued Shares	% of Fully Diluted Equity
<b>Class A Preference Shares</b>			
Shareholder 1	1,000,000	25.0%	21.9%
Shareholder 2	1,500,000	37.5%	32.8%
<b>Total Class A Preference Shares</b>	<b>2,500,000</b>	<b>62.5%</b>	<b>54.6%</b>
<b>Common Shares</b>			
Shareholder 3	500,000	12.5%	10.9%
Shareholder 4	200,000	5.0%	4.4%
Shareholder 5	100,000	2.5%	2.2%
Employee Trust	400,000	10.0%	8.7%
Directors Trust	300,000	7.5%	6.6%
<b>Total Common Shares</b>	<b>1,500,000</b>	<b>37.5%</b>	<b>32.8%</b>
<b>Total Issued Shares</b>	<b>4,000,000</b>	<b>100.0%</b>	<b>87.4%</b>
<b>Warrants</b>			
Shareholder 1	200,000		4.4%
Shareholder 2	300,000		6.6%
<b>Total Warrants</b>	<b>500,000</b>		<b>10.9%</b>
<b>Options</b>			
Optionee 1	50,000		1.1%
Optionee 2	25,000		0.5%
<b>Total Options</b>	<b>75,000</b>		<b>1.6%</b>
<b>Total Warrants and Options</b>	<b>575,000</b>		<b>12.6%</b>
<b>Total Fully Diluted</b>	<b>4,575,000</b>		<b>100.0%</b>

If management is proposing to award shares or options to employees, directors, or consultants, then provide a table showing the optionee, the number of options/shares, vesting details and a summary of the total share/options pools.

### Directors' Liability

Directors and Officers are personally liable for all unpaid wages, source deductions and most company taxes. Companies typically request the CFO to present a signed certificate at each Board meeting attesting that all required government remittances, including payroll deductions, GST, PST in all provinces and State Taxes in all States are current as of the date of the report.

## 4.9 Sample General Report to the Board

In preparing a report to the Board, you want to make it as easy as possible for the Directors to quickly understand the context so the contents of the report make sense.

First, let them know if the report is for information or whether they are making a decision based on the report: "I" items are for information; "D" items for decision.

Next, divide the report into 3 sections: Background, Discussion and Recommendation.

Background section: Explain the context for the report – why are they getting it, what is at stake, and if the report is a follow-up to a previous report, then refer to the date, title, and decisions of the previous report. This helps Directors "connect the dots" so they can understand the situation and arrive at a decision more quickly.

Discussion section: Briefly provide the facts and management's consideration. If a decision is needed, explain the rationale for the decision that management is requesting of the Board.

Recommendation section: This section only includes the Recommendations for the Board to adopt. The first recommendation is always to receive the report for information.

For example, here is a sample report requesting the Board to approve management's recommendation to enter into a new lease.

TO: Board of Directors of ABC Company

From: Charles Spittle, CFO

Re: DECISION ITEM D – 3: REAL ESTATE FOR 2012 – 16

Date: August 12, 2011

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### Background:

The lease on our current premises expires on December 31, 2011. The Company needs to find a new home. Fortunately, the vacancy rate in the Richmond area exceeds 20% and affords the company several good opportunities. Leases typically run for five years.

### Discussion:

We engaged Norm Sandhurst of ACE Commercial Realty Advisors (dummy names) to assist and advise us on the search, analysis and choice among various spaces.

A dozen or more spaces were initially visited from which a short-list of four was selected and subsequently narrowed to two. There were several considerations in the selection:

1. Cost. Basic rent, operating costs, free rent, required leasehold improvements, landlord's work, tenant improvement allowance, furniture acquisition, etc. all informed the total cost of the space over a five year period.
2. Flexibility. Given the impossibility of predicting the company's growth over five years, the ability to add additional space in the same building or close by, or conversely, to sublet unneeded space, was paramount.
3. Amenities, look-and feel. Clevest's assets are its people. A pleasant work environment is important to attract, motivate and retain the best people.
4. Cost of moving. All else being equal, it is easier to stay in the current space than execute another move.

The two final choices among the dozens considered were:

1. Site 1, a new space.
2. Site 2, out current space.

Appendix A to this report (not attached) summarizes the financial and qualitative factors for the two final choices. We considered the following:

1. Both places are about the same size.
2. Both places are in executive parks with potential expansion to adjacent buildings, but Site 2 has a decided edge. Note the site plans for both buildings attached to this report.
3. Rent at Site 2 is significantly more in the latter years of the term, but this additional cost is more than offset by free rent in 2012-13, cheaper furniture costs, lower improvement costs and not incurring the expense and downtime of a move. On a net present value basis, the spaces are virtually equal.
4. There is more free parking at Site 2.
5. Site 2 has a better feel to it: higher ceilings, and less crowded.

In weighing these factors, we considered that there was no real incentive to move to poorer quality space with less parking. Therefore, we are requesting the Board to approve our choice to stay at Site 2.

Recommendations:

1. That the Board of Directors receives this report for information.
2. That the Board of Directors approves management to negotiate a five year lease for the premises at Site 2 substantially on the parameters indicated in Appendix A to this report.

#### 4.10 Written Resolutions

A resolution signed by all directors is as valid as if the resolution had been passed at a meeting. A written resolution must be signed by all directors. By signing written resolutions directors forgo their ability to discuss matters. A template for written resolutions in lieu of a meeting is attached below.

#### CONSENT RESOLUTIONS OF THE DIRECTORS OF • (the "Company")

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The undersigned, being all the directors of the Company, hereby consent to and adopt in writing the following resolutions:

WHEREAS:

A.

B.

etc.

BE IT RESOLVED THAT:

1.

2.

etc.

#### **COUNTERPART EXECUTION**

BE IT RESOLVED THAT these resolutions may be signed by the Directors in as many counterparts as may be necessary, each of which is signed shall be deemed to be an original and such counterparts together shall constitute one and the same instrument and notwithstanding the date of execution shall be deemed to bear the date as set forth below. Executed copies of these resolutions may be delivered by electronic transmission and it shall not be necessary to confirm execution by delivery of the originally executed documents.

DATED effective as of the \_\_\_ day of \_\_\_\_\_, 20\_\_.

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Director 1

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Director 2

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Director 3

## 4.11 Review of Resolutions by Legal Counsel

A corporation must act in compliance with corporate, securities or other laws. Resolutions approving actions that must be made in compliance with such laws should be reviewed or drafted by legal counsel. Counsel's input is necessary to ensure that the corporation complies with applicable laws and also, in certain cases, to ensure that the resolution properly authorizes all requisite actions necessary to accomplish the intended objective. In some cases, such as share issuances, this latter issue is very important as the corporation's auditors or legal counsel may be required at a later date to express an opinion on or confirm details of the share issuance.

While it is difficult to list all items that may have legal implications, generally corporate actions relating to business matters such as budgets, department reports or corporate strategy do not involve significant legal issues. The following is a list of some matters that generally do involve legal issues:

- Issuance of any securities (eg. shares, warrants, agreements to issue shares, stock options);
- Entering into material agreements (eg. to borrow or lend money, to acquire other businesses or joint venture agreements);
- Granting of security to lenders;
- Changes to directors and officers;
- Calling and approving shareholder meetings;
- Fundamental corporate changes (eg. name change, consolidation, share split, creation of new class of shares, or dissolution – generally speaking these types of changes will require shareholder approval as well); and
- Creation of subsidiaries or fundamental changes to subsidiaries.

## 4.12 Role of the Corporate Secretary

### 1. Introduction.

Among the thankless tasks in a company, the Corporate Secretary role ranks near the top. It is purely an overhead function charged with organizing Board meetings, keeping the minute book and share capitalization schedules up to date. It is never noticed when it is done well, but can hurt a company if done poorly requiring a renovation of the books and records. The only saving grace is that if done well, it relieves the CEO, Chairman and other directors of a significant burden on their time. It may shorten the due diligence period during a financing or exit.

In an early stage tech company, the role often goes unfulfilled. The CEO and Board make do with unorganized reports, incomplete and inaccurate minutes, an inaccurate and outdated share cap table, and poor governance practices, because without a corporate secretary, no one has the time to manage the processes properly. If an institutional financing appears on the horizon, then there is an immediate and huge project to prepare and assemble the missing minutes and organize the minute book, confirm the issuance of shares and options, and attend to other corporate janitorial work that never got done.

Around this time, the company often hires a Chief Financial Officer who takes on the role of Corporate Secretary to bring professionalism to the Board and governance processes. In this capacity, although technically subordinate to the CEO and Board, the Corporate Secretary may in fact lead the Board through its responsibilities since s/he may know more about it.

Likely, all of the functions described in this chapter 4 will become the responsibility of the Corporate Secretary. Pay particular attention to section 4.0 Organizing a Board Meeting which lists the items that the Secretary is responsible for.

### 2. Board approvals.

In playing the role of corporate watchdog, the Secretary must anticipate the items that the Board needs to review and approve. The Board must review and approve the following items, either as a matter of good governance or as required by law:

- The issuance of all shares and options. Indeed, even though the Board has approved the issuance of options, they also have to approve the issuance of shares once the options have been exercised. During a financing or exit, the investors will carefully review the share cap table and will require the company's counsel to issue a legal opinion that all of the shares have been validly issued. This is the one item that may cause the greatest amount of rework if not done properly at the outset.
- The annual budget, 30 days before the start of the budget year.
- The monthly or quarterly financial statements, with a comparison to budget.
- A running cashflow projection several months into the future.

- Any long term commitments, like a building lease, or a large customer contract.
- Any large expenditures.
- Compensation for the CEO and senior executives.
- The annual reviewed or audited financial statements.
- The terms of any proposed financings and issuance of any term sheets.
- Any debt, equity or bank financings.
- Any items that also require the approval of investors pursuant to a shareholders' agreement.
- Any related party transactions. These are items where the company is doing business with a Director or senior executive. These include any loans to or from principals, any consulting or other contracts between the company and a principal or other business that is not at arms'-length.
- Any conflicts of interest. A conflict occurs when a principal is in a position where his personal interest and the company interest intersect. Whether or not the principal takes action in the midst of the conflict, even if such action is in the company interest, even the existence or appearance of the conflict is a cause for concern. If the principal does not declare the conflict and remove himself from situation causing the conflict, then the Corporate Secretary must inform the CEO and Chairman, and request that the Board review the conflict. (The principal should declare the conflict to the Board and remove himself from any discussion on the matter, and have this recorded in the minutes. This generally absolves the principal and the company.)
- As noted, it is up to the Corporate Secretary to keep track of these items and bring them to the Board for approval. It may be convenient to keep a running file of items to go before the Board at the next meeting, so that they are not overlooked when the next Board agenda is assembled.

### 3. Minutes and Minute Book.

The Corporate Secretary keeps the minutes of the Board meetings, and also maintains the Minute Book. He must ensure that all of the minutes are approved by the Board, signed by the Chairman and Secretary and inserted into the Minute Book. (This is often done online.) As noted, incomplete minutes may cause a lot of clean-up work in order for a financing or exit to proceed.

In addition, the minute book must also include any Directors' Resolutions signed by all Directors, which are typically a document required in a financing, acquisition or other major transaction requiring formal Board approval. Usually, these resolutions have to meet exacting legal standards and are therefore prepared by company counsel. The Corporate Secretary inherits the task of chasing directors for signatures.

Similarly, major transactions such as the creation of a new class of shares or the sale of assets may require the signatures of all shareholders. This may require the Secretary to find dozens of long lost shareholders and secure their signatures on a resolution which they may not understand for a company long forgotten. One of the many thankless tasks.

In addition, the Secretary must ensure that the annual report is filed each year with the Registrar of companies. Usually the company counsel will have this task on a perpetual calendar, and prepare the necessary documents. Recently, the task has become much simpler in B.C. as the province has enabled companies to file their own reports online.

#### 4. Annual General Meeting.

The Corporate Secretary also organizes and runs the AGM. Typically the meeting is held in the 5th month after month end, leaving enough time for the financial statement audit to complete, and issue the Notice of the AGM with the required notice period, both within the six month window in which the AGM must be held. The AGM is a mechanical process. The Secretary can obtain a template AGM script from the Company counsel, which indicates the steps required to call the meeting, declare a quorum, elect the directors, and question management. The Chairman will follow the script, usually with the guidance of the Secretary.

## **5. Downloads**

Section 5 on the website allows you to download the entire site in either Word or pdf format.

## **6. Written Articles**

From time to time, through some administrative error no doubt, some of the ideas in this manual find their way into print form. This section includes some of those articles and where they were printed.

## 6.1 Boards are even more important for start-ups

A highly performing Board of Directors is more often critical to the success of a technology start-up company. Here are some common challenges:

- Inexperienced management. Most tech companies are founded by young entrepreneurs. Typically, they lack experience in the many facets of growing a successful technology company: planning, budgeting, human resources, finance, governance, risk management, etc.
- Under capitalized. Most technology companies do not have the cash to hire experienced senior executives. Consequently, many founders perform many functions themselves for which they are not trained and ill-suited.
- Rapid change. The technology industry moves quickly. Decisions must be made quickly often without all of the information required.
- Large consequences. Often, an opportunity or a problem can have significant impacts. Whereas larger, more mature companies can diversify their risks, early stage companies are often confronted with a single, "bet the company" decision.
- Hubris. Also called "Founder's Syndrome", technology entrepreneurs are typically high-energy, confident people. While this strength of character is essential to driving the company through the many challenges, it has a dark side. Many entrepreneurs believe they have all the answers and want to make all the important decisions themselves. Frequently they over-rule decisions with which they do not agree. This behaviour typically prevents the company from growing, and can often cause it to fail.

In later articles, we will explore how experienced Boards can help start-ups overcome these inherent limitations.

*This article first appeared in the Winter 2007 edition of The Hire Standard – the newsletter of Corporate Recruiters, British Columbia's leading recruiters of high technology talent.*

## **6.2 What Should Boards of Early Tech Companies Do ?**

In early stage technology companies, the Board is more proactive in advising management on a range of operational issues, and holding management accountable for its decisions, actions, or lack of action.

That said, however, the Board does not overturn management decisions, nor substitute its judgment for the judgment of management. It does not make operational decisions in lieu of management. To do so would usurp management's proper role and involve the Board too deeply, both of which would be harmful to the company.

To manage the balance between oversight and meddling, on important issues the Board should request that management present to the Board for its approval a recommendation based on the facts and analysis of the case. The Board should review the report, and probe management's analysis of the facts and how the analysis supported its decision and recommendation. The Board should ensure that management has considered all of the material facts and outcomes.

The Board can and should withhold approval of management's decision and recommendations if the analysis is weak or does not support the decision and recommendations, and request management to return with an improved report. Of course, if the Board believes that the recommendation is contrary to the best interests of the company, it should withhold approval. In this way, the Board leaves the responsibility for recommendation and action with management, while providing oversight and guidance.

*This article first appeared in the Spring 2008 edition of The Hire Standard – the newsletter of Corporate Recruiters, British Columbia's leading recruiters of high technology talent.*

### 6.3 Directors Need to be on Common Ground

One of the many challenges for a Board of Directors for an early-stage technology company is the need to quickly develop a common understanding among all the Directors as to their individual and collective roles. Why is this important? In early-stage technology companies, major business events can arise requiring the Board to advise management quickly on a course of action. Over time, it ensures a consistency of action and builds credibility for the Board.

In a crisis, there may not be sufficient time for management to gather all the data, do a thorough diligence review of the information, prepare scenarios and back-up plans, and present to the Board at its next meeting, and then for the Board to consider the information, scenarios, and risks, discuss among the Directors and deliver its advice. Often, the issue must be decided within a few days outside the context of a regular Board meeting<sup>1</sup>.

Boards are often poorly-equipped to effectively respond to these challenges. At a time when the Board needs to provide considered and consistent advice, the Directors may not have even met in person. This happens when Directors live out of town and management decides not to spend its limited funds on travel. Their only contact may be a scratchy teleconference call with interference from Bluetooth devices, lost cell sites, etc. Direct voice communications are difficult under these circumstances. Reading body language to sense Directors' feelings on the issue may be impossible. Usually, there is precious little time for the important discussion. Directors may feel rushed into making a critical decision under pressure.

It can get worse. Directors are often chosen for different reasons. At least one company Founder, who is often the CEO, is usually on the Board to represent founders, management and employees. Typically, the founder has the best sense of the company's technology, and often its markets. Angel investors often sit on the Board to provide the practical advice that comes from their years of experience. Larger investors may have the right to appoint representatives to the Board who, fiduciary duty to the company notwithstanding, seek to ensure that the investors' needs are given priority. With divergent interests, the Board may not have a common understanding upon which to base their advice.

It may not occur to the Directors to specifically develop a mutually agreed set of expectations to guide their deliberations, perhaps naively believing that the Board will "come together" over time. However, if a major issue arises unexpectedly and the Board is called into action, the Board may be ill-equipped to respond due to a lack of a common frame of reference. In such a case, the Board may chew up valuable time discussing the basics of their roles and responsibilities and the practical meaning of fiduciary duty, so they can all get to common ground before they debate the issue at hand. They may never get there under the pressure of time, and the Directors may not be able to render the advice that management needs and must have. Occasionally, divergent views at a time of crisis can lead to a permanent rift in the Board, which negates its very reason for existence.

The lack of a common frame of reference is vividly exposed in a crisis, but it is important even over the long term. Directors need to develop and support common rules of engagement for all

matters. For example, the fine line between questioning management's recommended course of action on an issue, and substituting their own decision on the matter, is a line that all Directors need to understand and support. Otherwise, the Board may not be able to confidently render its advice to management, and importantly, build the credibility and trust that is essential to its role.

So a common frame of reference is important not just in a crisis, but over the longer term. How can an early-stage technology Board develop their common understanding? First, the Chairman must take the lead. It is one of the Chairman's primary responsibilities to develop the Board so that it can effectively guide management.

If the company can afford to do so, a weekend retreat is an excellent forum. The Chairman, with the assistance of the Board Secretary, can develop an agenda and source various references on the topics of fiduciary duty, roles for the Directors, chairman, and Board, expectations for management and the Board, and so on. This might take the form of a draft Board manual. While this is a very time-consuming task, there are templates available that can be adapted to suit the company (see [www.earlystagetechboards.com](http://www.earlystagetechboards.com)). Away from the daily administrivia, Directors and management can focus solely on the topics and develop their common understandings.

In the absence of a retreat, the Chairman should dedicate an entire Board meeting to developing its mandate. This meeting should be held at the earliest opportunity, not just to be prepared for an unexpected event, but also because the sooner the Board is on the same page, the more effective it will be.

The outcome of the retreat or Board meeting should be a Board manual or other written document which describes the expectations of Directors and management. It is easy to misunderstand or to forget a verbal consensus. By reducing it to writing, ambiguities can be exposed for resolution. There will be a permanent record for future reference. New Directors will have a document to speed up their integration with the other members of the Board.

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<sup>1</sup>If the decision is a major one, then the Chairman may need to quickly call a Board meeting to decide this one issue. The company articles should include provision for waiver of the statutory notice period to schedule a Board meeting if all Directors agree.

*This article first appeared in the Summer 2009 edition of [The Hire Standard](#) – the newsletter of [Corporate Recruiters](#), British Columbia's leading recruiters of high technology talent.*

## 6.4 Managing Fiduciary Duty – Charting the Course

Proper exercise of the fiduciary duty of the Board of Directors is fundamental to a company's success. In venture-stage companies, performing fiduciary duty well and transparently builds confidence and trust in the Directors – essential if the Board is to mentor the CEO and guide the company's progress.

However, there are pragmatic challenges in executing fiduciary duty cleanly and transparently in early-stage technology companies. This is because many Directors and investors do not agree on what constitutes good governance. A group of venture capitalists (VCs) and consultants in Silicon Valley have developed a series of white papers articulating best practices for Boards and Directors of venture-stage technology companies [i], [ii]. While the articles claim a 'company-first' focus, they also note that when push comes to shove, VCs are not bound to act in the interest of all shareholders. This excerpt is quite instructive:

*"The largest active shareholders and those who elect the Board are in fact the same people. Therefore the VC Board member is less compelled to listen to the voice of other shareholders than his publicly traded company counterpart ... the investors that do the most work, have the most money at risk, and have the best track records will continue to drive the venture company's agenda. Attempts to 'level the playing field' in the name of good corporate governance are surely inapplicable to venture capital." [i]*

In addition, there is often a shareholders' agreement that assigns many decisions to the VCs, such as veto on sales of assets, selection of the CEO, and restrictions on creating new classes of shares. This agreement in effect transfers residual control on many crucial matters to the investors.

Advocates of good corporate governance may find these long-standing practices disturbing. By reserving certain rights, VCs are inhibiting the Board's ability to exercise its fiduciary duty on behalf of the company and its shareholders and this diminishes the role and credibility of the Board.

However, there is a growing sentiment that the inability or incapability of the Board to exercise its fiduciary duty is a major contributing factor in the poor performance of many venture-stage technology companies. Stricter practices are needed to improve governance and corporate performance.

The pragmatic challenge is that there are many experienced people who are willing to serve as Chairperson of early-stage technology companies. Most independent Directors (when they can be found) are chosen for their industry knowledge and operational experience, not for their governance abilities. That said, corporate governance is not a mystery and it is incumbent on all Directors to acquaint themselves with best practices and act accordingly.

Stay tuned for next issue's article, which will delve further and examine how to steer the ship of fiduciary duty in a sea of conflict.

[i]. "A Simple Guide to the Basic Responsibilities of VC-backed Company Directors", Working Group on Director Accountability and Board Effectiveness, Chairman Pascal Levensohn, Oct 2007.

[ii]. Dennis T. Jaffe, Ph.D, Pascal Levensohn: "After the Term Sheet: How Venture Boards Influence the Success or Failure of Technology Companies", Nov 2003.

*This article first appeared in the Spring 2010 edition of [The Hire Standard](#) – the newsletter of [Corporate Recruiters](#), British Columbia's leading recruiters of high technology talent.*

## 6.5 Steering the Ship of Fiduciary Duty in a Sea of Conflict

Last newsletter, we examined [best practices and challenges associated with managing fiduciary duty](#). With a context for governance in place, let us move to scenarios, because there are pragmatic challenges in exercising fiduciary duty transparently in situations where conflicts abound.

The most common problem is when a company embarks on the next round of financing. If the company is performing well and there appears to be a healthy increase in the share price, everyone is happy and the nuances of fiduciary duty and transparency may not be critical.

However, if the venture capitalist (VC) is participating in the financing, then the VC Director's interests as a VC and his fiduciary duty to the company are in conflict because they are on opposite sides of the table in the financing, whether or not the financing is favourable to all parties.

A more complicated problem occurs if the company is not performing well, and if the financing may be detrimental to the interests of existing investors (i.e. the infamous "down round"). In this case, the participating VC Directors are in conflict, and so are any Directors who hold shares that may be diluted by the contemplated financing. Founders and management Directors who hold management positions are also in conflict because they may perceive (often correctly) that their performance has contributed to the company's need for a down round, and therefore their jobs, compensation and unvested equity may be at risk. The independent Directors may be the only ones without a conflict, but they may not have the interest or experience to navigate a contentious Board to a consensus on a difficult issue.

How does the Board operate in this stormy sea of conflicts?

In the case of only one or two Directors, if an actual or apparent conflict arises, the best action is for the conflicted Directors to voluntarily declare the conflict and withdraw themselves from any discussion on the topic and to abstain from a vote. Failing that, the Chairperson or another Director should identify the conflict to the Board and request the Board to rule. If a conflict is deemed to exist, the Board must request that the conflicted Directors recuse themselves. This should also be reflected in the minutes to make it transparent.

If a VC Director is in conflict, he or she can legitimately argue that with the most money at risk, they have a material interest in the issue in conflict. True, but there must be a clear distinction between the role of Director and investor. If a VC Director wishes to advance the interest of his investors, he should declare the conflict, and recuse themselves from the issue in question, in order to advance their interest as the investor to management and the Board. The VC Director would remain a Director to deliberate on other issues not in conflict. To make it even more transparent, the VC investor could appoint another VC principal to represent the VC investor's interest, leaving the Director out of the discussion. Directors must still recuse themselves from both the discussion and the vote.

What if all Directors are in a real or apparent conflict, as noted above? They cannot all recuse themselves, since there would be no one left. In this case, pragmatism must prevail: the conflicts must be declared in the minutes, and there must be a Board decision to allow all the Directors to participate in the discussion and the vote. However, fiduciary duty must still be seen to prevail, and Directors must be careful to ensure that the company's interest is paramount in all the discussions.

→ *added May, 2016*: In cases where there is a sea of conflicts, such as the financing above, Directors can absolve themselves of the real and apparent conflicts by asking all of the shareholders of the company to sign a special shareholders resolution which clearly lists all of the Directors' and their funds' shareholdings, states the terms of the financing and how it will affect each class of shareholders, and asks the shareholders to acknowledge the conflict, approve the financing and to hold the conflicted Directors harmless.

In the case of a down round, investors should consider the value of the new investment in terms of the company's ability to pursue its goals, and not by the impact on the current investors; management should similarly ignore the potential threat to their individual positions. Directors may want to write a justification for their recommendations and decisions based on the company's interest so that they can verify that they acted in their fiduciary duty to the company.

The process improvements mentioned above are important. Strict and transparent adherence to the process of fiduciary duty encourages all Directors to act in the company's best interest, and is critical to building trust and confidence in the Board.

In sum, improved performance of venture-stage technology companies demands transparent accountability. When in conflict, if possible, Directors must recuse themselves from discussion and votes related to the issue at hand. In all cases, the governance process must be transparent to ensure that best practices are observed.

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## 6.6 When Does Management Cross the Line?

Whether through inexperience, or a reluctance to relay bad news and to take responsibility for it, there are times when management is less than completely forthcoming with the Board. These occasions test the mettle of the directors, both in evaluating how serious the incident may be, and what to do about it. Let's take a couple of examples:

**Case 1: Management withholds certain information from the Board.** On the one hand, the Board does not want to hear a long list of operational problems that are management's to solve, but on the other hand, it must have the material information to make proper decisions. The test should be that if the information or lack of it could change the Board's course of action, then that information must be disclosed. But what if it isn't? What should the Board do when it finds out?

**Case 2: Management failing to abide by the Board's direction.** If the Board has approved a course of action and management does not follow through, how serious is the problem? If management is tardy, the issue may not be serious, and easily dealt with. However, if management willfully disobeys clear directions, then the Board must act.

**Case 3: Spending money outside the approved budget or making material decisions without seeking Board approval when required.** This may happen frequently. In a rapidly changing situation, management often acts expediently. How should the Board react?

In a mature company, transgressions like these might be dealt with formally. However, in an early stage technology company, Boards need to exercise discretion and restraint. Often the errors arise from a lack of experience in times of stress. Properly managed by the Board, the incidents should be an opportunity to educate management and the Board. Trust should strengthen.

Disciplinary action should be a last resort and applied only in cases where there has been willful misconduct. Should it come to this, trust between management and the Board may be irrevocably broken, leading to worse problems down the road.

In most cases, constructive criticism in the form of an informal chat between Chairman and CEO should be sufficient. If there has been a pattern of minor events contrary to the Board's direction, then the Board may issue a verbal reprimand in an informal meeting so as not to be minuted. In the rare event where management has willfully acted against the Board's explicit direction, then a formal written reprimand in the minutes of a Board meeting may be required. Serious cases, of course, could be grounds for termination.

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## 6.7 Should I Stay or Should I Go?

In the beginning, taking on a Directorship looks like a good idea: a chance to lend time and expertise to a young high-tech company, mentoring the executives, advising on strategic and operational issues, and maybe even making some money on the options at exit time.

But several months in, the situation has become desperate: the company is in trouble, milestones have been missed, there is dissension in the ranks, and the company is running out of money. Directors are putting a lot more time into the company, and none of it is fun. They may also be worried about their personal liability. So, should a Director stay or should they go?

This is the most critical decision that any Director can make. There is a lot riding on it: money, time, reputation, stress, and not necessarily in that order. If a Director decides to step down, it should only be done as a last resort, as it can send a strong negative signal about the company's prospects. Here are some points to consider in making your decision:

**Reputation:** As soon as someone takes on a directorship, 100% of their credibility is on the line. If the company does well, directors will get some of the credit. If it does poorly, most of the blame will go to management, but directors can also be (rightly) chastised for not doing their job. If Directors stay the course when times are tough, they will earn more accolades than by backing out. Provided that a director can positively influence events (more on this below), it is better to stay.

**Time:** When things were good, a Director could probably do their fiduciary duty in a couple of hours per week. Now that the company is in trouble, it takes a lot more time. Directors can reduce their time commitment by refusing to take on management's responsibility. If managers can't manage, replace them. However, if you can't replace them, you will need to review the management team more closely, which will unfortunately take more time.

At the point that increased time demands begin to seriously interfere with a Director's other commitments, the Director needs to act before the strain affects all their other responsibilities. If a Director truly cannot devote the time required, he or she may have to step down.

**Probability of success:** Directors need to dispassionately assess whether the problems within the company can be fixed. Speak with management and request a workout plan for the Board's consideration and approval. Review it critically, query management's thinking, and assess the potential outcomes, the probability of success, and the risk of execution. If there is a reasonable chance to save the company, then Directors should stay the course and advise management in the implementation of the survival plan.

If the chances of saving the company hinge on a combination of several low-probability events, then a dispassionate Director may rightly conclude that prospects for survival are slim. If the Director is unable to persuade the company to adopt a better strategy, then he or she may resign in good conscience.

Mistaken strategy: Discussions and disagreements are healthy and important for a board, as they help to ensure that issues are fully considered. However, on major points of strategy, all Directors must support the Board's final decisions. If a Director is fundamentally at odds with the direction or actions of the company, then he or she may need to resign on principal.

Personal liability\*: Directors are personally liable for unpaid wages and all required remittances to the government which are incurred while they are a Director, including source deductions (income tax, CPP, EI), GST, PST, and HST. If a Director discovers that the company is behind on any of these obligations, he or she cannot escape the liability incurred up to that point by resigning. (This can come as quite a shock.)

To prevent this problem, Directors should, from the outset, require management to deliver regular reports on the status of all government remittances, and outline whether the company can meet its payroll and other obligations. One method for Directors to mitigate their personal liability is to require that all remittances and obligations be paid out on every payroll if a company is in financial trouble. This action reduces the amount of liability that may arise. Directors can then make the decision to stay or go at the end of each payroll period, if liability is a driving concern.

Options under water: Typically, the only compensation for a Director is his or her options package. When the company is in trouble, the options may be worthless and unlikely to recover for a long period, if ever. However, this is never a reason to resign. A Director's duty is to the company and not to his or her net worth. Furthermore, a Director's reputation would suffer greatly to cut and run simply because the options are under water.

Confidence in management: Directors are only effective when there is mutual trust and respect amongst the board and management. However, these bonds may be ruptured if management is perceived to be making poor decisions, acting unethically, or ignoring the advice of the board. Broken trust is almost impossible to rebuild.

As well, in early-stage technology companies, the founders are often critical to the progress of the company because of their domain knowledge. The founders cannot be easily replaced in the short term and, if they hold the majority of the shares, they cannot be replaced at all.

Without trust, Directors cannot advise and influence management, and their impact is thus reduced. They cannot effectively exercise their fiduciary duty to act in the best interest of the company. At this point, either management or the Director must go. If management is secure, then the Director has no option but to resign.

In most cases, a Director is compelled to stay on because of their duty to act in the best interests of the company, and because the Director's reputation might suffer if he or she were to cut and run prematurely. As mentioned above, Directors can be insulated from liability with proper planning and reporting.

However, in the case where a Director is fundamentally opposed to the company direction, or Directors and management have lost trust in each other, a Director cannot be effective and resignations must follow.

**\*Note: Nothing in this article should be construed as providing legal advice. Readers are cautioned to seek legal advice only from competent, licensed professionals.**

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## 6.8 Less Minutes Equals Less Mischief

The exhausting marathon Board meeting (is there any other kind?) is over and the CFO/Corporate Secretary confronts pages of notes from the discussions. He has to turn these into a professional set of minutes that exude credibility and demonstrate that the Board has been diligent in exercising its fiduciary duty.

He might be tempted to render a full account of the discussion on each topic the Board reviewed to indicate that the Directors considered the issues in depth, weighed the alternatives and rendered a decision that reasonably balanced the pros and cons of the issue. It is, after all, the requirement of directors to examine the issues, ask questions and bring prudent judgement to bear. Perhaps the minutes should fully document their deliberations?

Typical practice suggests not, as there are several problems with complete disclosure. Auditors, shareholders, potential financiers, acquiritors and others all have access to the minutes. A few may read the minutes because they have axes to grind with the company or its management and directors. A revelation that the Board considered a course of action, even if it was not adopted, might be sufficient to make mischief. In other cases, potential acquiritors may learn something of the company's strategy that they otherwise wouldn't, and non-disclosures notwithstanding, gain some advantage from the revelation.

For these reasons, companies typically include only the bare bones of the discussion in the minutes. In this approach, the minutes indicate the nature of the issue, that a "brief" or "full" discussion ensued, and any motion that was adopted as a result of the discussion. For example, the Board might have a vigorous discussion about a matter of company policy, with different and conflicting viewpoints articulated. Eventually the Board might come to a decision and adopt a course of action. The minutes would read:

"The Board reviewed the company policy with respect to x. A full discussion ensued. ON MOTION DULY MADE, SECONDED AND CARRIED, IT WAS RESOLVED THAT the following course of action be adopted: xxx".

Competitors and suitors can't learn much from that disclosure. At the same time, the minutes indicate that the Directors exercised their fiduciary duty in the full discussion and the decision taken.

Notwithstanding the brevity, Directors can always request that certain comments be reflected in the minutes. This is especially applicable if they disagree with a decision and don't want to be liable for its consequences.

In sum, corporate secretaries should keep the minutes brief and to the point. The Board can demonstrate the exercise of its responsibilities even with brief disclosure, and the company can minimize the opportunity for mischief.

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## **6.9 You have my time – now you want my money too?**

Many companies take the view that a Director is required to act in good faith in the best interests of the company, to be fully informed of the material issues, and to protect the interests of the shareholders. Once appointed, a Director invests their time and expertise and has 100% of their personal reputation riding on their performance as a Director and on the success of the company. If the Director is giving reasonable efforts to the task, nothing more can be gained by requiring him or her to invest personal money as well. Many Directors take this point of view and resist investing their own money, whether or not they can afford to.

Some might argue that a personal investment creates a conflict, as the Director's duty to serve the best interests of the company may not always serve personal interests. For example, if the company is performing poorly and needs investment, it may be priced well below the price at which the Director invested. There is a conflict between the Director's personal desire to preserve his or her position, and the need of the company for cash.

In small tech companies, the requirements of Boards and Directors are onerous. Because of the inexperience of management and holes in the management team, Directors may need to invest more time and energy to bridge the gaps. Inevitably, the company will face a crisis from time to time, whether it is strategic, financial, an issue of governance, or a disagreement among the Board or with management. It is all too easy for a Director to resign in the face of seemingly irreconcilable differences, or the challenges of survival and growth in a tech company.

But if a Director has made a significant personal investment, the stakes are higher. He is less likely to resign, and/or less likely to be forced off the Board. Further, in recognition of the significant investment in time, energy, and personal capital required to be an effective Director in a start-up tech company, Directors are also compensated higher.

Therefore, a Director who resigns not only loses oversight of his personal investment, but also walks away from significant equity compensation. There is a much greater personal onus to weather the storm and continue to resolve the critical issues.

While a committed Board should benefit the company by forcing solutions to difficult issues, it can also backfire. Where there are opposing entrenched positions on important issues, and no one steps aside, the consequences can be severe. Paralyzed by Board fracture, the company often has no conclusive mandate. Often significant time and energy of the management team, and the CEO in particular, are spent attempting to resolve Board issues for which they are usually ill-equipped and always at a power disadvantage. Companies have failed in the process.

The arguments for and against Director investment are not clear-cut. However, the arguments in favour of requiring Directors to invest are stronger and companies that institute this practice would likely not be criticized.

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## 6.10 The Loneliness of the Corporate Secretary

Pity the poor Corporate Secretary, who has a role that few understand and fewer appreciate. Organizing Board meetings, keeping the minute book and share capitalization schedules up-to-date, organizing the Annual General Meeting; none of this stirs the blood of an entrepreneurial tech company but is nonetheless necessary.

In an early stage tech company, the role often goes unfulfilled. No one has the time to manage the processes properly, so the CEO and Board make do with unorganized reports, incomplete and inaccurate minutes, an inaccurate and outdated share cap table, and poor governance practices.

If an institutional financing appears on the horizon, the company often hires a Chief Financial Officer who takes on the role of Corporate Secretary to keep the records in order and bring professionalism to the Board and governance processes. In this capacity, although technically subordinate to the CEO and Board, the Corporate Secretary may in fact lead the Board through its responsibilities since s/he may know more about it.

Here are some of the items the Corporate Secretary needs to manage:

**1. Board approvals.** As the corporate watchdog, the Secretary must anticipate the items that the Board needs to review and approve, such as:

- The issuance of all shares and options, including shares issued on exercise of previously approved options. A financing or exit will require the company's counsel to issue a legal opinion that all of the shares have been validly issued. If the share cap is wrong or out of date, there will be delays and costs to bring it in order before the opinion can be rendered.
- The annual budget, 30 days before the start of the budget year.
- The monthly or quarterly financial statements, with a comparison to budget.
- A running cashflow projection several months into the future.
- Any long term commitments, like a building lease, or a large customer contract.
- Any large expenditure.
- Compensation for the CEO and senior executives.
- The annual reviewed or audited financial statements.
- The terms of any proposed financings and issuance of any term sheets.
- Any debt, equity or bank financings.
- Any items that also require the approval of investors pursuant to a shareholders' agreement.

- Any related party transactions. These are items where the company is doing business with a Director or senior executive. These include any loans to or from principals, any consulting or other contracts between the company and a principal or other business that is not at arms'-length.
- Any conflicts of interest. A conflict occurs when a principal is in a position where his personal interest and the company interest intersect. Whether or not the principal takes any action, the mere existence creates an appearance of conflict. If the Director and Board are unaware of the need to address the conflict, then the Corporate Secretary must inform the CEO and Chairman, and request that the Board review the conflict.

It is up to the Corporate Secretary to keep track of these items and bring them to the Board for approval.

**2. Minutes and Minute Book.** The Corporate Secretary keeps the minutes of the Board meetings, and also maintains the Minute Book. S/he must ensure that all of the minutes are approved by the Board, signed by the Chairman and Secretary and inserted into the Minute Book. (This is often done online.)

In addition, the minute book must also include any Directors' Resolutions signed by all Directors, to approve a financing, acquisition or other significant events. Usually, these resolutions have to meet exacting legal standards and are therefore prepared by company counsel. The Corporate Secretary inherits the task of chasing directors for signatures.

Similarly, major transactions such as the creation of a new class of shares or the sale of assets may require the signatures of all shareholders. This may require the Secretary to find dozens of long lost shareholders and secure their signatures on a resolution which they may not understand for a company long forgotten.

In addition, the Secretary must ensure that the annual report is filed each year with the Registrar of companies. Usually the company counsel will have this task on a perpetual calendar, and prepare the necessary documents. Recently, the task has become much simpler in B.C. as the province has enabled companies to file their own reports online.

**3. Annual General Meeting.** The Corporate Secretary also organizes and runs the AGM. Typically, the meeting is held in the 5<sup>th</sup> month after month end. This allows time for the financial statement audit to complete and to issue the Notice of the AGM with the required notice period within the six month window in which the AGM must be held. It is the Corporate Secretary's job to assemble the documents and distribute to the shareholders.

The Corporate Secretary has a lonely and thankless job, constantly keeping track of a multitude of reports and details that only cost time and money. However, a well-maintained set of records gives confidence to investors and acquirers, and this may shorten the time and reduce the costs of a major transaction.

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## **6.11 Judges or Mentors – Directors Must Lead**

Directors of early-stage technology companies have two roles that are not always in harmony. A large part of their fiduciary duty to the company is to advise and mentor management teams that are often young and inexperienced. Directors need to give CEOs and other executives a lot more latitude than might be provided in more experienced companies, in order to let the CEOs make mistakes and learn from them. Identifying areas needing more work or decisions that might have been made differently are part of the mentoring process. Also importantly, directors need to be available to CEOs when they ask for help and advice. To do this, directors must earn the trust of CEOs in order to expose those areas where they need help.

However, Directors are also responsible to ensure that the CEO has the requisite set of skills and judgement to lead the company and so must constantly be sitting in judgement. If necessary, directors may need to replace a CEO who is not performing well.

From the point of view of the CEO, this is a real conundrum. On the one hand, s/he should ask for help when needed, and accept and be guided by advice from the Board when given. But on the other hand, each error or weakness might be added to a lengthening list of oversights that might ultimately get her or him fired. (It is not surprising that there are many support groups for CEOs, including AceTech, Young Presidents' Organization, TEC and many informal mentoring arrangements where CEOs can discuss issues with their peers without exposing weakness to the Directors who sit in judgement.) While the onus may be on the CEO to seek guidance from his Board, many CEOs might not want to take the risk.

With this in mind, the onus should clearly shift to the directors. They need to develop a rapport with the CEO that inculcates a culture that provides support first, guidance second, and criticism last. Given the risks perceived by the CEO, this may take a long time and many conversations before the Directors can build sufficient trust to permit the CEOs to open up.

A few protocols may help the Board get there sooner:

1. Directors should state plainly that their responsibility is to support the CEO in all decisions s/he makes, even if the Directors don't agree with them. This should give the CEO more confidence in taking the initiative to identify needed improvements and make changes.
2. Directors should also establish that the CEO will never be criticized or held to account on issues for which they ask for advice and guidance. This may help the CEO open up sooner.
3. Finally, the Board should also be clear that they will not seek a change in the CEO's position without first clearly laying out the areas of improvement needed in the incumbent, and giving him or her a fair opportunity to make those improvements. (This would not, of course, be extended to instances of malfeasance or misconduct.) This may give the CEO the confidence and trust that s/he will not be blind-sided by the Board, or replaced without a fair chance to meet clear expectations.

If the Board can establish this working protocol with the CEO, then the CEO should feel much more secure in asking for guidance where needed, and welcoming advice from the Board. Overall, the company should benefit from a greater ability to bring the experience and wisdom of all Directors into play.

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## 6.12 Duty of the CFO – to the CEO or Board?

Sometime in the first few weeks on the job, a new CFO should anticipate a low-key meeting with the Chairman of the Board or the Audit Committee to develop the trust and working relationship key to a well-managed and well-governed company. Don't be surprised if in the course of the meeting, the Chairman pulls the CFO aside and reminds her that the Board expects the CFO to provide a sober, realistic view of the company's progress that the Board can rely on. After all, the CEO is expected to be positive and upbeat at all times, whereas the CFO is expected to maintain a clear, unemotional view based on the facts. Sounds reasonable?

In fact, the CFO should get a sinking feeling in her stomach, because the Chairman has put her in a very uncomfortable position. The CFO's primary responsibility is to the CEO, and they must be completely in harmony with each other, with a shared vision and message. Trust is paramount, without which the relationship cannot succeed. (The movie *Crimson Tide* contains a memorable scene where Gene Hackman as submarine commander explains this concept in no uncertain terms to his first officer Denzel Washington). Investors and the Board test this relationship and if they are receiving mixed messages, it may be the first sign of trouble in the company.

Yet the CFO also has a duty to provide plain, true and complete disclosure to the Board. As long as the Company is executing well, then complete disclosure paints a glowing picture of health. But what if there are problems that the CEO would rather not discuss? Does the CFO have an obligation to disclose? If so, does this come at the cost of damaging the essential trust between the CEO and CFO?

Potential conflicts can be mitigated with open communication. The CEO and CFO must agree on the protocol for reporting to the Board so that there are no surprises. Early on in the relationship, the CFO should tell the CEO that the Board is expecting the CFO to report directly on all financial and operational matters under her review so that the CEO is aware of the dual reporting aspect of the CFO's position. The CFO should make very clear to the CEO that the contents of any discussion with a director will always be disclosed to the CEO so that there are no hidden messages.

The CFO should provide drafts of all reports to the Board to the CEO first. While the CEO can suggest improvements, the CEO must leave the final version to the discretion of the CFO, otherwise it is not her report. This sharing of communications will shine light on any differences so that they can be ironed out prior to disclosing to the Board. Importantly, it ensures that the CEO and CFO are, and appear to be, in harmony.

So what happens if the CFO has a different point of view than the CEO? One of the subtle ways to highlight the differences without betraying trust is for the CFO to emphasize the key points and to explain the risks associated with the course of action contemplated. In this way, the CFO can support the CEO while providing more complete information for the Board to evaluate.

This may also be the way for the CFO to gently correct the CEO if there are any errors made during the Board meeting. The CFO can offer to provide some “background” on a certain point which subtly corrects the error without drawing attention to it.

If a disagreement arises between the CEO and CFO that cannot be bridged prior to a Board meeting, then the CFO can write a memo to file in which she notes the disagreement, her position and/or recommendation to the CEO and the result. While this does not absolve the CFO of any liability should the resulting action not turn out well, it would at least indicate to the Board on subsequent review that the CFO’s concern was expressed to the CEO at the appropriate time.

Finally, does the CFO’s fiduciary duty to the company compel her to approach the Board if she perceives that the CEO’s actions or judgment are mistaken, which can often occur in early stage tech companies with young and inexperienced CEOs? Typically, the answer is “no”. It is the Board’s responsibility to evaluate the CEO, and the Directors should exercise their diligence as a matter of course. For the CFO to initiate that review independently would directly violate the trust between CEO and CFO described earlier, and so she must demur and let the Board find its own way. If the issue is important enough that the CFO cannot in good conscience remain silent, then the CFO must be prepared to resign first before expressing concerns to the Board.

In sum, the CFO’s dual reporting responsibility to the CEO and the Board is recognized as a potential conflict. Complete sharing of all verbal and written reports allows the CFO to report to the Board without violating the CEO’s trust. Errors and differences can be gently managed at Board meetings, but material disagreements may require the CFO to resign rather than violate the CEO’s trust.

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## **6.13 Governance Practices by Stage of Growth for Early Stage Technology Companies**

This is the first in a series of articles that summarizes the governance practices which early stage technology companies should employ at each stage in their corporate growth. The complete article is found at [section 3.17](#) on the [earlystagetechboards](#) website.

### Governance evolves:

The entire content of the site is designed to provide a manual and a set of best practices for early stage technology companies to obtain the best value from their Boards of Directors. Governance, however, is not static. Technology companies may start out with only a rudimentary, if any, governance system. As a company grows, its governance practices must evolve to ensure that the company and its management are performing to ever higher standards and receiving the oversight and advice that are appropriate to that stage of the company's development.

Too often, governance is neglected amongst the rapid change and hard work that characterizes early-stage technology companies. The required documentation and oversight are not considered or implemented until a problem is uncovered, which may jeopardize a major transaction or an exit.

### Problems with poor documentation:

For example, in a typical tech start-up, all of the focus is on the development of the new product and scant attention is paid to accounting. Shares and options are distributed widely because there is no cash to pay people. Later, when the founders look to angels to finance the company, they are stopped in their tracks when the angel asks to see the financial statements and the share cap table. The longer the gaps in the documentation exist, the greater the consequences. As the company progresses, it may look to negotiate a financing or strategic partnership. To close the deal, the company's lawyer must write a clean legal opinion that all of the shares have been validly issued. If there is not a clear paper trail formerly authorizing the issuance of all shares and options, the lawyer cannot deliver a clean opinion and the deal may fall through as a result.

### Serious consequences:

That said, early stage companies often don't have the resources to put in place the sophisticated documentation and governance systems required of more mature companies. Let's start with one practice essential to all companies, regardless of their stage of growth: the IP assignment.

### Essential practice, IP assignment:

Starting with the creation of a technology company, it is imperative that every founder, employee, director, contractor and advisor signs an intellectual property (IP) assignment agreement that assigns all rights and title to the company for any and all technical and business development done in the context of their association with the company. There is no touchier subject for investors and acquirers than IP. The company must be able to show that every person or company who ever contributed to the IP has assigned all rights to the company. This eliminates the possibility of some long-departed employee emerging years later to assert IP rights just as a transaction is about to close. It can be expensive and time-consuming to deal with those alleged rights, and many potential acquirers would rather pass. But it is best to eliminate

the problem from the outset. Buy or beg someone for a template that you can use for everyone associated with the IP.

Also, it is advisable to have everyone sign non-disclosure agreements (NDAs) and non-compete agreements. This creates negative consequences for someone disclosing company secrets or using the company's knowledge to compete with it. The IP assignment, NDA, and non-compete clauses can all be included in every employment agreement or contractor agreement. Again, buy or borrow a template.

Subsequent articles will explore other governance practices which companies should incorporate as they grow and can allocate more resources.

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## 6.14 Governance Practices at the Start-up and Angel Stages of Growth

(Note: This is the second in a series of articles that describe best practices for corporate governance at successive stages of growth of early stage technology companies. You can view the first article, "Governance Practices by Stage of Growth for Early Stage Technology Companies", at section 6.13.)

### Raw Start-up Stage

A technology company typically starts up with a couple of people with a new idea to change the world. They set up shop in a basement or lab, incorporate a company, give themselves some shares, open a bank account and settle down to the risky business of wiring circuit boards or writing code. Receipts go into a box. The only financial information is the monthly bank statements, if they remember to download them in time. They may be able to raise some financing from the "4Fs", founders, family, friends and fools, in the form of subscriptions to common shares. Advice and oversight is at best the labour of love from a kindly uncle or interested friend. The hard-working founders measure their progress against the development schedule for their new project, working to get it launched before their meagre funds run out. Customers and revenues are in the distant future.

At this stage, there is little governance or artifacts. All efforts are on birth, development and survival. Since the founders are accountable only to themselves and the other 3 Fs, this is appropriate.

### Angel Stage

The picture should change abruptly when the first angel investor writes a cheque. At this stage, the company is showing some progress with the product. They may have captured a few innovative customers who are willing to act as beta test sites to provide feedback on the initial product. An angel investor can see a future potential and is prepared to risk a modest investment, but will likely want to see some controls and documentation put in place. An expense budget will be the first item. The company will need to hire a part-time bookkeeper to pay the bills, mind the cash, and produce an income statement and balance sheet each month, and a report on the actual versus budgeted expenses. This will provide at least a modicum of control on the company finances. The company may also discover that they have to file income tax returns and GST or HST returns at the end of the year. As the requirements increase with the company's growth, experienced accountants will need to be hired, and eventually a controller.

Until recently, angels were content to purchase common shares and stand alongside the 4Fs in the queue. Often, if valuation couldn't be agreed upon, the angels would make their investment in the form of a debenture, which would convert to common more angels are demanding preferred shares to give themselves a preference over the 4Fs on sale of the company or its assets.

At this point, the company should formally approve an Employee Stock Option Plan (ESOP) before it begins to issue options to employees and directors. If options are issued before there is a formal ESOP, the accounting for stock options becomes very complicated.

This is also the time to formally constitute a Board of Directors for the company. Many would argue that the angel stage is too early for the overhead of time that a Board requires. To the contrary, the time invested by a committed and experienced Board will repay itself many times over by guiding the company and its founder managers through the multiple challenges that companies encounter at the angel stage. This is discussed at length throughout the [www.earlytagetechboards.com](http://www.earlytagetechboards.com) website.

- The Board should include at least one angel or independent director with experience in growing companies through the early stages.
- The Board should meet monthly, and spend the majority of its time reviewing the CEO's operations report which should include at a minimum the status of the development schedule, the sales funnel, and the next financing.
- The Board should also review the monthly financial statements, and a report of the budget versus actual expenses.
- The Board should formally approve all issuances of shares and options, and approve any term sheets to raise financing.
- The Board should establish a materiality limit for contracts and other transactions and formally review and approve all contracts which exceed this limit.
- All Board decisions must be captured in formal minutes that are filed with the company lawyer in the Minute Book.

The company should maintain an up-to-date registry to record the issuance of shares and options. Regular updates should be filed with the company lawyer for the minute book, or at the very least at the end of every fiscal year.

This is a lot to accomplish for a company that is undoubtedly stretched for cash and human resources, and it may take a year or so to implement all of the pieces. An experienced Chief Financial Officer or Operating Officer can manage all of this as part of their regular duties but few companies at the angel stage believe that they can afford the investment in that level of experience. The return on the investment in these procedures is two-fold: first and foremost, the company will be better managed. The experienced Board can guide the company away from typical pitfalls and towards desirable goals. A regular monthly review at Board meetings forces the management team to take stock and re-focus. Secondly, maintaining proper records at this stage will avoid horrendous problems down the road when a major financier or acquirer conducts formal diligence.

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## 6.15 Governance Practices at the Venture Growth Stage

(Note: This is the third in a series of articles that describe best practices for corporate governance at successive stages of growth of early stage technology companies. You can view the first article, "Governance Practices by Stage of Growth for Early Stage Technology Companies", at 6.13, and the second article, "Governance Practices at the Start-up and Angel Stages of Growth", at 6.14).

At the venture growth stage, the company is achieving its goals. They have proven their business model and revenues are accelerating. Early adopters are embracing the product, and the company is beginning to gain traction among mainstream customers.

This is the point at which the company used to look for a Series A round of venture capital to fund its growth. However, since the burst of the tech bubble in 2000-2001 and the global financial meltdown in 2008-2009, the venture capital sector has severely retreated. The asymmetry of venture capital investments is also now becoming better understood. As a result, many technology companies are looking elsewhere for expansion capital. The angel networks are filling some of the void. Whereas angels previously invested independently and somewhat secretly, angels are now formally organizing themselves into angel investment groups. These groups aggregate the diverse talents and experiences of the angel members to improve the breadth and depth of diligence, and also syndicate investments to increase the quantum and share risk.

Financial controls and documentation increase at this stage. The company will have an experienced accounting team with segregated duties, including a Controller and CFO or Director of Finance. The investors will require the company to engage an external accounting firm, typically one of the big 4 (KPMG, Deloitte, pwc, or Ernst & Young), but they may also accept one of the excellent second-tier firms like BDO Dunwoody, Grant Thornton, Meyers Norris Penney, or dozens of others. The company will need to produce full accounting statements with notes prepared according to GAAP, IFRS or ASPE, and have the external firm either review or audit them. A history of reviewed, or better, audited financial statements by a recognized firm is very reassuring to potential investors or acquirers, so the earlier the company engages the auditor, the better.

The Company's financial systems must strengthen in this phase. The CFO must prepare an annual budget for the Board to review and approve prior to the start of the year, including projection for the income statement, balance sheet and cash flow. The CFO must report variances against the budget for each month and Board meeting, with a summary discussion, and a forecast for the balance of the year. The accounting team will closely manage accounts receivable and payable to closely monitor and forecast cash balances.

The Company should compile and maintain electronically a due diligence binder containing copies of every important document in running the business. These include all material contracts, and also financial statements, share cap table, sales funnel, development plans, investor presentations, product descriptions, list of Intellectual Property, market studies, and so on. A detailed table of contents for a diligence binder is widely available online or from the company counsel. A comprehensive and well-organized diligence binder is helpful and credible to the financing and acquisition processes.

One of the most frustrating financial statement requirements that appear at this stage is stock-based compensation. GAAP, IFRS, and ASPE rules require that companies calculate an arbitrary value for the stock options that vest over the course of the year and recognize it as an expense on the income statement. The calculation is arduous as it must be performed for every stock option and adjusted if the option is exercised or cancelled. The amount of the expense is often significant and distorts the income statement. Many companies resort to reporting an “adjusted EBITDA” calculation that removes stock-based compensation along with other non-cash charges so that readers, like the Board of Directors, can obtain a clearer picture of the company’s financial performance.

Another serious challenge arises when the company starts making sales in the U.S. Most companies discover only after many months and sales go by that they may be required to collect and remit sales tax individually to each state in which they sell products or services, and in many cases, even at the city or county level. In fact, there are 16,000 tax jurisdictions in the U.S. The rules are complex and steadily tightening as the states grab every tax dollar they can, particularly from foreign companies who do not vote. To mitigate the exposure, it is advisable that every contract and sales order includes language that requires the U.S. customer to self-assess and remit state sales tax. Many customers, particularly large ones and government entities do self-assess, but nonetheless the onus remains with the supplier. U.S. state sales tax compliance is an area where companies should engage experienced help. The large accounting firms can help, but at significant cost. There are also boutique firms who specialize in U.S. tax compliance for small Canadian companies at more reasonable cost. If the company opens up an office, or hires employees in the U.S., they may also be required to file income tax returns to the IRS and to the state government, with large potential penalties for late filings.

As the rules tighten, the exposure grows for Canadian companies. US tax exposure is now an item of due diligence for investors and acquirers. Target companies need to demonstrate that they are knowledgeable and in compliance with U.S. income and sales tax provisions and can reasonably estimate their exposure. Companies that are not sufficiently diligent may be at risk not just from the taxes, interest and penalties, but also from the collapse of financings or acquisition.

The Board of Directors continues to broaden and deepen its oversight in this phase. The Board may be restructured to ensure that there are a majority of either independent directors, or directors appointed by the investors. The Board should constitute an Audit Committee to continuously review the financial statements, accounting policy, and preparations and execution of the annual review or audit. The Board should also strike a Compensation Committee consisting only of non-management directors to review and approve executive and Board compensation annually. The Board should continue to meet monthly until the company is comfortable generating positive cash flow.

The Company should also be holding formal Annual General Meetings to receive the financial statements, elect the Board of Directors, and in general account to the shareholders for the performance of the executive team.

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## 6.16 How to Maneuver a Successful Board Meeting

How does a start-up CEO determine whether or not the board meeting that just finished was successful?

A successful Board meeting does not just happen; rather, the CEO has to plan and execute it. In an early stage hi-tech company, there may (and should be) an independent chairperson with whom the CEO plans the agenda and executes the meeting. The CEO will write the CEO report that documents progress and problems in executing the strategic and operating plans. It will be the key topic at the board meeting.

In the discussion of the CEO report, it is important that the CEO explain the thought process that led him or her toward the actions taken. The CEO wins or loses points with the board based on the reasoning that informed the decision. Whether the decision was the right one can only be answered in hindsight, and often it is a case of "right decision, wrong outcome." An experienced board will understand the difference. It is an achievement when the CEO gains the support of the board for sound decisions made based on the information available, even if the outcome was not ideal.

However, a successful board meeting requires more than a status update and justification of actions. The directors are there to support the CEO by providing the benefit of their experience and wisdom. And they never feel better than when asked for advice on important matters, so that they can guide the CEO and company in the right direction.

Therefore, it is wise for the CEO to reflect on upcoming challenges and pick a few to outline in the CEO report, specifically asking the board for advice. As well, the CEO will want to work with the chairperson to make sure there is sufficient time allocated to discuss the issues. The directors will have read the CEO report and had time to reflect on the challenges before the meeting. At the meeting, the CEO will communicate with the chairperson to ensure that the directors have the opportunity to comment fully, and then gather the consensus and indicate the course of action for the company, based on the board's advice.

In summation, a successful meeting is one where the board members are called upon to advise the CEO, and their advice is followed up on and put into action. The directors are engaged, the CEO gains the benefit of their advice, and usually the decisions will be better for the advice taken. And as a bonus, the process will help strengthen the relations amongst all involved. Success all round.

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