

THE EFFECT OF NEW REGULATIONS UNDER THE *CHARITIES ACCOUNTING ACT*

By Terrance S. Carter, B.A., LL.B.

A. BACKGROUND TO REGULATION

This Bulletin No. 4 provides a more detailed commentary from Bulletin No. 1 on regulation 04/01, adopted under Section 5.1 of the *Charities Accounting Act* by the Public Guardian and Trustee of Ontario (“PGT”) on February 3rd, 2001 (“the Regulation”). A copy of the Regulation is attached to this Bulletin as an Appendix.

The Regulation had been anticipated ever since Section 5.1 of the *Charities Accounting Act* was passed in 1996. Section 5.1 authorized the adoption of regulations by the Attorney General to permit certain prescribed activity involving charitable property that would otherwise have required the approval of the Superior Court of Justice. This involved the following:

- ◆ permitting directors to receive remuneration from charities on whose boards of directors they sit;
- ◆ permitting charities to indemnify trustees, executors, directors and officers for personal liability arising out of their offices, as well as to purchase directors and officers liability insurance;
- ◆ allowing charities to co-mingle multiple restricted funds held by the charity into a single account or investment portfolio.

B. NO RELIEF TO COMMON LAW RULE PROHIBITING DIRECTORS FROM RECEIVING REMUNERATION:

Unfortunately, the Regulation that was adopted does not authorize directors and trustees to receive any remuneration from the charity on which they serve. Therefore, the common law rule in Ontario still applies, i.e. that directors of a charity, in their quasi trustee role, have a fiduciary obligation not to put themselves into a conflict of interest by receiving remuneration, either directly or indirectly, from the charity on which they serve as a director. The Public Guardian and Trustee has indicated that further regulations dealing with this issue may be passed in the future but, for now, the current common law in Ontario continues to apply. Consequently, it will continue to be necessary for the board of a charity and its legal counsel to ensure that the charity's by-laws and other constating documents do not permit the remuneration of directors other than for reimbursement of out of pocket expenses.

Some of the consequences arising of the new Regulation failing to authorize the remuneration of directors are as follows:

- ◆ Charities may continue to find it difficult to attract qualified candidates to their board of directors where those candidates are providing goods and services to the charity, either at or below market value, such as inexpensive or pro-bono services by a lawyer or accountant.
- ◆ Some religious charities for doctrinal reasons may find it theologically unacceptable that their minister cannot be a member of the controlling board of the church simply because the minister receives remuneration from the church. In those situations, it may be necessary for churches or other religious organizations to make an application for a consent order from The *PGT* under section 13 of the *Charities Accounting Act* to permit such payment.
- ◆ For those charities that do not want to go to the trouble or expense of obtaining a consent order from the *PGT*, an alternative would be to structure the by-law and other constating documents of the charity so that the employee in question, such as an executive director, will not be a member of the Board of Directors but will be given substantive rights over the day to day operations of the charity, including the right to receive notification of all board meetings, be present at all board meetings, and participate at all board meetings (save and except when such board meetings are dealing with the position of the Executive Director) but without such person being a member of the board of directors. For a more detailed discussion concerning issues involving remuneration of directors, see articles by the author entitled "*Remuneration of Directors in Ontario*" and "*Update on Remuneration of Directors in Ontario*" available at www.charitylaw.ca.

C. INDEMNIFICATION OF DIRECTORS AND OFFICERS AND LIABILITY INSURANCE

Under the Regulation, a charity may indemnify a trustee or executor or, where the executor or trustee is a corporation, indemnify the directors or officers of the corporation for personal liability arising from an act or omission in performing his or her duties. However, a charity may not indemnify a director or officer for liability arising from a failure to act honestly and in good faith in performing those duties.

The ability of a charitable corporation to adopt an indemnity by-law had been in question as a result of an error in the wording in previous amendments to the *Corporations Act*. However, this omission has recently been corrected through a further amendment to the *Corporations Act* which now ensures that Ontario non-share capital corporations can indemnify their directors and officers, provided that the requirements of the Regulation adopted under the *Charities Accounting Act* have been followed.

The Regulation also provides that insurance may be purchased to cover personal liability arising from the act or omissions of the executors, trustees, directors or officers of a charity in performing their duties. However, the terms of the insurance or indemnification must not impair a person's right to bring legal action against the executor, trustee, director or officer. In addition, the Regulation states that the purchase of the insurance policy must not unduly impair the carrying out of the religious, educational, charitable or public purposes for which the charity holds property. The Regulation further states that the executor or trustee, and if the executor or trustee is a corporation, the board of directors of the corporation, must consider the following before giving an indemnity or purchasing insurance:

- ◆ The degree of risk to which the executor, trustee, director or officer is or may be exposed;
- ◆ Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance;
- ◆ Whether the amount or cost of the insurance is reasonable in relation to the risk;
- ◆ Whether the cost of the insurance is reasonable in relation to the revenue available to the charity; and
- ◆ Whether it advances the administration and management of the charitable property to give the indemnity or purchase the insurance.

The Regulation states that no indemnity may be paid or insurance purchased if to do so would result in the amount of debts and liabilities exceeding the value of the charitable property or, if the executor or trustee is a corporation, render the corporation insolvent. Another limitation is that the indemnity may only be paid or the insurance purchased from the charitable property to which the personal liability relates and not from any other charitable property. This would appear to mean that the income from segregated funds, such as endowment funds, that would otherwise not normally attract potential liability for a director or officer should not be used to purchase directors and officers liability insurance or to pay an indemnity.

The consequences of the Regulation permitting indemnification of directors and officers of a charity and the purchase of liability insurance can be summarized as follows:

- ◆ It will be important for the directors of a charity to carefully review all of the Regulation to ensure that the directors are complying with its terms before proceeding with the adoption of an indemnification by-law or the purchase of directors and officers liability insurance.
- ◆ If the charity complies with the Regulation, it is important to determine whether the indemnification by-law has been passed and/or insurance has been purchased prior to the publication of the Regulation on February 3rd, 2001. Since the Regulation is not stated to be retroactive, it is possible that an indemnification by-law adopted prior to the publication of Regulation 04/01 may need to be passed as a new by-law or may require the adoption of a current resolution that the board of directors have reviewed the conditions and terms of Regulation 04/01 and are satisfied that the indemnification in question and/or the purchase of liability insurance complies with the terms and conditions of the Regulation.
- ◆ Since charities will in most circumstances now be able to purchase directors and officers liability insurance from the funds of the charity, it will become less problematic to recruit qualified volunteers as directors to its board of directors.

D. CHARITIES MAY CO-MINGLE RESTRICTED AND SPECIAL PURPOSE FUNDS:

Under the Regulation, a charity may now co-mingle property funds received for a restricted or special purpose with other properties similarly received into a single account or investment portfolio. However, a number of restrictions and obligations are imposed by the Regulation which may make the option of co-mingling funds difficult or impractical. In this regard, a charity that is intending to co-mingle property or funds held for restricted or special purposes:

- ◆ May only do so if it advances the administration and management of each of the individual restricted funds;
- ◆ Must allocate all gains, losses, income and expenses rateably on a fair and reasonable basis to the individual funds; and
- ◆ Must maintain detailed records relating to each individual fund, including the following:
 - ◆ the value of the individual fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
 - ◆ the value of any portion of the individual fund that does not become part of the combined fund;
 - ◆ the source and the value of contributed fund (i.e. additional fund that is added to and forms part of a pre-existing individual fund) relating to an individual fund, and the date on which the contributed fund is received;
 - ◆ the value of the contributed fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
 - ◆ the amount of the revenue received by the combined fund that is allocated to the individual fund, and the date of each allocation;
 - ◆ the amount of the expenses paid from the combined fund that are allocated to the individual fund, and the date of each allocation; and
 - ◆ the value of all distributions from the combined fund made for the purposes of the individual fund, and the purpose and date of each distribution.
- ◆ Must maintain detailed records relating to the combined fund, including the following:
 - ◆ the value of each individual fund that becomes part of the combined fund, and the date on which it becomes part of the combined fund;
 - ◆ the value of each contributed fund that become part of the combined fund, the date on which it becomes part of the combined fund, and the details of the individual funds to which the contributed fund relates;
 - ◆ the amount of the revenue received by the combined fund, the amount allocated to each individual fund, and the date of each allocation;
 - ◆ the amount of expenses paid from the combined fund, the amount allocated to each individual fund and the date of each allocation; and
 - ◆ the value of all distributions from the combined fund made for the purposes of an individual fund and the purpose and date of each distribution.

In light of the double records that must be maintained and the detail required for those records, a charity may decide that it is simpler and less problematic to maintain each restricted or special purpose trust fund in a separate account for investment purposes notwithstanding the likely lower rate of return for the over all portfolio investment of the charity. It is therefore important for the board of directors of a charity to weigh the benefits to be gained from combining restricted and special purpose funds against the significant administrative costs and aggravation of keeping the necessary records in order to co-mingle restricted and special purpose funds. It is also important for the board of a charity to realize that co-mingling restricted or special purpose funds in contravention of the Regulation will expose the directors to allegations of breach of trust and resulting personal liability.