

The Effect of New Regulations under the Charities Accounting Act

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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; and
- allowing charities to co-mingle multiple restricted funds held by the charity into a single account or investment portfolio.

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.

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.

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 or 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.

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REGULATION MADE UNDER THE CHARITIES ACCOUNTING ACT

APPROVED ACTS OF EXECUTORS AND TRUSTEES

Ontario Regulation 04/01
Filed: Jan. 17, 2001
Gazette: Feb. 3, 2001 (proposed)

APPROVAL OF SPECIFIED ACTS

- 1.(1) The acts authorized by this Regulation that would otherwise require the approval of the Superior Court of Justice in the exercise of its inherent jurisdiction in charitable matters shall be treated, for all purposes, as though they had been so approved.
- (2) Subsection (1) does not constitute authorization of an act that conflicts with one of the following in a particular case:
 1. The will or the instrument in writing relating to the property.
 2. A court order relating to the will or instrument or relating to the property.
- (3) An executor or trustee must maintain records demonstrating that he, she or it has complied with the requirements of this Regulation when engaging in an act that is authorized under subsection (1).
- (4) An executor or trustee is not required by virtue of this Regulation to give any indemnity or to make any payment.

AUTHORIZATION TO INDEMNIFY

2. (1) In the circumstances and subject to the restrictions set out in this section, an executor or trustee and, if the executor or trustee is a corporation, each director or officer of the corporation may be indemnified for personal liability arising from their acts or omissions in performing their duties as executor, trustee, director or officer.
- (2) An executor, trustee, director or officer cannot be indemnified for liability that relates to their failure to act honestly and in good faith in performing their duties.
- (3) In the circumstances and subject to the restrictions set out in this

section, insurance may be purchased to indemnify the executor, trustee, director or officer for the personal liability described in subsection (1).

(4) The terms of the indemnity or insurance policy must not impair a person's right to bring an action against the executor, trustee, director or officer.

(5) The executor or trustee or, if the executor or trustee is a corporation, the board of directors of the corporation shall consider the following factors before giving an indemnity or purchasing insurance:

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

(6) The purchase of insurance must not, at the time of the purchase, unduly impair the carrying out of the religious, educational, charitable or public purpose for which the executor or trustee holds the property.

(7) No indemnity shall be paid or insurance purchased if doing so would result in the amount of the debts and liabilities exceeding the value of the property or, if the executor or trustee is a corporation, render the corporation insolvent.

(8) The indemnity may be paid or the insurance purchased from the property to which the personal liability relates and not from any other charitable property.

(9) If the executor, trustee, director or officer is deceased, the indemnity or the proceeds of the insurance may be paid to his or her estate.

COMBINING PROPERTY HELD FOR RESTRICTED OR SPECIAL PURPOSES

3. (1) In this section,

contributed property” means, in respect of an individual property, additional property that is added to, and forms part of, a pre-existing individual property.

(2) In the circumstances and subject to the restrictions described in this section, an executor or trustee may combine property received by the executor or trustee for a restricted or special purpose with other property received by the executor or trustee for another restricted or special purpose and may hold the combined property in one account in a financial institution or invest it as if it were a single property.

(3) The property may be combined only if it advances the administration and management of each of the individual properties to do so.

(4) All gains, losses, income and expenses must be allocated rateably, on a fair and reasonable basis, to the individual properties in accordance with generally accepted accounting principles.

(5) The executor or trustee must maintain the following records for each of the individual properties, in addition to such other records as may be required by law:

1. The value of the individual property immediately before it becomes part of the combined property, and the date on which it becomes part of the combined property.
2. The value of any portion of the individual property that does not become part of the combined property.
3. The source and the value of contributed property relating to an individual property, and the date on which the contributed property is received.
4. The value of the contributed property immediately before it becomes part of the combined property, and the date on which it becomes part of the combined property.
5. The amount of the revenue received by the combined property that is allocated to the individual property, and the date of each allocation.

6. The amount of the expenses paid from the combined property that are allocated to the individual property, and the date of each allocation.
7. The value of all distributions from the combined property made for the purposes of the individual property, and the purpose and date of each distribution.

(6) The executor or trustee must maintain the following-records for the combined property, in addition to such other records as may be required by law:

1. The value of each individual property that becomes part of the combined property, and the date on which it becomes part of the combined property.
2. The value of contributed property that becomes part of the combined property, the date on which it becomes part of the combined property, and details of the individual property to which the contributed property relates.
3. The amount of the revenue received by the combined property, the amount allocated to each individual property and the date of each allocation.
4. The amount of the expenses paid from the combined property, the amount allocated to each individual property and the date of each allocation.
5. The value of all distributions from the combined property made for the purposes of an individual property and the purpose and date of each distribution.