THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO
BOARD OF DIRECTORS RESOURCE MATERIALS

Due Diligence in Avoiding Risks for Directors of Charities and Not-For-Profits

(Power Point Presentation)

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A. OVERVIEW OF TOPICS

- Due diligence in the choice of charitable structures
- Due diligence in relying upon statutory protection
- Due diligence in operations
- Due diligence in indemnification and insurance
- Other means of due diligence in reducing risks

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B. DUE DILIGENCE IN THECHOICE OF CHARITABLE STRUCTURES

- Using existing charities as an alternative to a new charity
  - Option of using existing charity may be simpler and less expensive than creating a new charity
  - But increases the exposure of board of directors of existing charity to personal liability

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- **Charities as unincorporated associations**
  - **Use of unincorporated association is simpler, faster and less expensive**
  - **But exposes members and leaders to personal liability**
- **Charities as Corporations**
  - **Separate legal entity protects members from personal liability**
  - **Directors may still be exposed to personal liability from fiduciary and management responsibilities**

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- **Using a multiple charitable corporation structure**
  - **Multiple charitable corporations can help to protect charitable assets in one charity and contain liabilities in another charity**
  - **Need integrated corporate structure and trade-mark licensing to avoid loss of control**
  - **Multiple charitable corporations can include parallel foundations and associated operating charities**
  - **Parallel foundations have become more common in protecting long term gifts and endowment funds as a result of the Christian Brothers decision**

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- **Multi-tiered provincial or national charities**
  - **Single corporate structure provides ease of administration, but results in greater risk of liability exposure for total assets of single corporate entity**
  - **Multiple corporate structure reduces risk of liability, but top tier organization may still be exposed to liability where too much control is imposed or employer/employee relationship exists**
- **Need to avoid overlapping board of directors to reduce the chance of crossover liability**

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C. <u>DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION</u>

- **Protection from third party contractual liability**
  - **Protection available for corporations under the *Canada Corporations Act* (CCA) but not under *Corporations Act* (Ontario) (OCA)**
  - **Protects directors and officers against contracts entered into within the scope of authority of directors or officers**

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- **Protection from conflict of interest**
  - **Both CCA and OCA permit directors to remain on the board of directors where a director declares a conflict of interest**
  - **Common law rule, though, does not permit directors to remain on the board even if conflict of interest declared**

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D. <u>DUE DILIGENCE IN OPERATIONS</u>

1. The Rights and Powers of a Director in Exercising Due Diligence

- **Corporate authority**
  - **Directors need to know governing documents of the charity**
  - **Directors must not authorize *ultra vires***
  - **Amendments to governing documents may be necessary**

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- **Management access and control over the affairs of the corporation**
  - **Directors are responsible for all aspects of operations of the charity**
  - **Directors must be proactive in management and not be limited to setting policy only**
- **Protection of charitable assets**
  - **Directors have a fiduciary duty to protect charitable property**
  - **Need to invest in accordance with prudent investment standard under the *Trustees Act* (Ontario)**

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- **Need to protect intellectual property including trademarks and the goodwill of the charity**
- **Fundraising**
  - **Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts**
  - **Ensure gifts are used for charitable purposes**
  - **Review and enforce terms of restricted and endowed gifts**
- **Notice/attendance at meetings/minutes**
  - **Right to notice of board meeting**
  - **Right to attend board meeting**

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- Right to vote
  - Equal voting rights
  - Must declare conflict of interest
  - Need to record contrary vote
- Appropriate delegation
  - Can delegate day to day operations, including officer duties
  - But directors must retain control and require accountability

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2. Policies and Procedures in Achieving Due Diligence

- Establishing and following policy statements and procedures
  - Develop policies and procedures for staff, volunteers and board members
  - i.e. Policy statements on sexual abuse, sexual harassment, counseling and third party property use of facilities of the charity

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- **Screening procedure**
  - **An appropriate screening process is an important protection against increase in abuse claims**
  - **Screening involves utilizing appropriate questions, interviews, reference of employees and volunteers together with police checks when individuals are dealing with children**
- **Training/education**
  - **Directors should maintain their skills and knowledge in the area of the charity's current operation**
  - **Directors need to educate themselves about changes in the law affecting directors' duties**

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  - **Directors need to ensure that senior management are also kept adequately informed on current legal issues**
- **Utilizing due diligence checklists**
  - **General liability checklist**
  - **Sexual abuse checklist**
  - **Fundraising compliance due diligence checklist**
  - **Anti-terrorism due diligence checklist**
  - **Insurance checklist**

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3. Reliance on Professional Advice in Achieving Due Diligence

- **Management**
  - **Directors need to retain professional managers to oversee operations**
  - **Directors are responsible for activities delegated to management**
  - **Directors should receive and review reports from management at every board meeting**

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- **Outside professionals**
  - **Relying on professional advisors like accountants and lawyers, provides evidence of due diligence**
- **Delegation of investment decision making to investment manager requires agency agreement and investment policy under *Trustee Act (Ontario)***

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E. DUE DILIGENCE IN INDEMNIFICATION AND INSURANCE

1. Statutory Basis for Directors and Officers insurance and Corporate Indemnity

- **Federal and Ontario corporate statutes now permit corporate indemnity and director and officer insurance**
- **But in Ontario, charities must first consider the following under the *Charities Accounting Act* (Ontario)**
  - **What is the degree of risk?**
  - **Are there alternatives to insurance?**
  - **What is the cost of insurance in relation to the risk?**

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- **What is the cost of insurance in relation to revenue?**
- **Does indemnity or insurance further the management of charitable property?**

2. Corporate Indemnification

- **Corporate indemnification provides compensation for the following:**
  - **Legal fees**
  - **Fines that were paid under a statute**
  - **A financial settlement that result from a lawsuit**
  - **Any other obligation that a director was required to fulfill**

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- **Corporate indemnification should always be implemented but may be of limited benefit**
- **Indemnification is only as good as the financial state of the charity**

3. **Insurance Considerations**

- **Insurance policies to consider obtaining would include**
  - **General liability insurance**
  - **Directors' and officers insurance**
  - **Sexual abuse and/or harassment**
  - **Insurance for particular risks, i.e. counseling, non-owned auto, third-party use of property, etc.**

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- **Factors to consider**
  - **How much coverage does the policy provide for?**
  - **Does insurance cover all past and present directors, officers and committee members?**
  - **Is coverage on a "claims made basis" or on an "occurrence basis"?**
  - **Are there exclusionary clauses that limit the protection offered by the policy, such as sexual abuse?**
  - **Are there geographical limits to the coverage?**

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– **Insurance will likely not provide coverage for actions by public authorities for breach of trust, improper investments, or violations of the *Anti-terrorism Act* (Canada) or other similar strict liability legislation**

- **Advise agent in writing each year of all activities of the charity and all known risks**

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- **Ask agent/insurance company to respond in writing to the following:**
  - **What risks are covered?**
  - **Who is covered under the policy**
  - **What is the amount of the coverage?**
  - **What risks are not covered under the policy?**
  - **What additional insurance should be obtained by the charity?**

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F. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK

1. **Legal Risk Management Committees**

- **Legal risk management committee need to be formed to conduct review and identify risk**
- **Need to conduct ongoing review of assets and risks utilize legal risk management checklist**

2. **Independent Legal Advice**

- **Independent legal advice needed for directors in high risk situations**

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- **Directors may need to seek independent legal advice before resigning from the board of directors**

3. **Size of the Board**

- **Reducing size of board reduces risk**
- **Smaller board may also allow for more effective control**

4. **Committees and Advisory Boards**

- **Committees and advisory boards can be an effective means of attracting volunteers without the risk of being directors**

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- But board of directors must always remain in control

5. Transfer of Assets

- Directors will always be somewhat exposed to liability risks
- Therefore directors should consider transferring personal assets to spouse
- However any transfer of assets must be done before becoming a director so as not to defeat claims of creditors

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