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 risk

Note: For a more detailed discussion, see attached Appendix C. See also Chapter 6 Risk Protection by Terrance S. Carter in “Primer for Directors of Not-For-Profit Corporations” at http://www.carters.ca/pub/book/2002/dirprimc6.pdf

B. DUE DILIGENCE IN THE CHOICE 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
• 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

• 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

• 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
C. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- 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

- 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 of a charity to remain on the board even if conflict of interest declared

D. DUE DILIGENCE IN OPERATIONS

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* activities
  - Membership approval may be required
  - Amendments to governing documents may be necessary
• 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
• Pro-active 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)
  – Take an inventory of charitable assets
    • Review annual financial statements
    • Review bank statement and records
    • Review past and current restricted fund
    • Review property deeds
    • Comply with statutory requirements

– Protecting and managing intellectual property
  • Registering trade-marks and copyright
  • Securing internet domain names
  • Proper marking of trade-mark and copyright
  • Licensing of trade-mark and copyright
### Fundraising
- Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts and other applicable disbursement quotas
- 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

### 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
- Establish an audit committee for finances and legal liability

### 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, work place safety, counseling and third party use of facilities of the charity
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

- Directors need to ensure that senior management are also kept adequately informed on current legal issues

Utilizing due diligence checklists
- Legal Risk Management Checklist
- Sexual abuse checklist
- Fundraising compliance due diligence checklist
- Anti-terrorism due diligence checklist
- Insurance checklist

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
• Outside professionals
  – Relying on professional advisors like accountants and lawyers provides evidence of due diligence
  – Reduces exposure to liability
• Delegation of investment decision making to investment manager requires agency agreement and investment policy under Trustee Act (Ontario)

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?
  – 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
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.

Factors to consider:
- How much coverage does the policy provide for?
- Who are the named insured?
- 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?

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), Bill C-45 amendments to the Criminal Code (Westray Mines) or other similar strict liability legislation.

Advise agent in writing each year of all activities of the charity and all known risks.
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?

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

3. 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
• 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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