

**INSTITUTE OF CHARTERED
ACCOUNTANTS OF ONTARIO
DIRECTOR AND OFFICER LIABILITY
AND BEYOND
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**Part III
Due Diligence in Avoiding Risks
for Directors
of Charities and Not-for-Profits**

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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 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/dirprimch6.pdf>

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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

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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. 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

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

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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

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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**
- **Pro-active protection of charitable assets**
 - **Directors have a fiduciary duty to protect charitable property**

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- **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**

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- **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**

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- **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

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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
 - Establish an audit committee for finances and legal liability

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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, work place safety, counseling and third party 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**
 - Legal Risk Management 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
 - Reduces exposure to liability
- **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?**
 - **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?**

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- **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**

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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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