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**CANADIAN SOCIETY OF ASSOCIATION EXECUTIVES  
SOCIETE CANADIENNE DES DIRECTEURS  
D'ASSOCIATIONS  
LEGAL ISSUES FOR ASSOCIATIONS CONFERENCE**

**Ottawa - January 27, 2005**

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**Avoidance of Risks by Directors  
of Charities and Non-Profits**

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**By Jane Burke-Robertson**

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PROFESSIONAL CORPORATION**

BARRISTERS, SOLICITORS & TRADE-MARK AGENTS  
Affiliated with Fasken Martineau DuMoulin LLP

**Main Office Location**

211 Broadway, P.O. Box 440  
Orangeville, ON, Canada, L9W 1K4  
Tel: (519) 942-0001  
Fax: (519) 942-0300  
Toll Free: 1-877-942-0001

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**OVERVIEW OF TOPICS**

- **Due Diligence In Operations**
- **Understanding the Duty of Care**
- **Due Diligence in Relying Upon Statutory Protection**
- **Indemnification and Insurance**
- **Other Means of Due Diligence in Reducing Risk**

**Note:** For a more detailed discussion, see also Chapter 2, 3 and 6 by Jane Burke-Robertson and Terrance S. Carter in “Primer for Directors of Not-for-Profit Corporations” at  
<http://www.carters.ca/pub/book/2002/dirprimch2.pdf>  
<http://www.carters.ca/pub/book/2002/dirprimch3.pdf>  
<http://www.carters.ca/pub/book/2002/dirprimch6.pdf>

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**DUE DILIGENCE IN OPERATIONS**

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

- **Corporate authority – Vested in Directors**
  - **Directors need to know and understand governing documents of the corporation**
  - **Directors must not authorize *ultra vires* activities**
  - **Membership/governmental approval may be required for certain corporate actions**
  - **Amendments to governing documents may be necessary**

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- **Right to vote**
  - **Equal voting rights**
  - **Need to record contrary vote**
  - **Must declare conflict of interest**
- **Notice/attendance at meetings/minutes**
  - **Right to notice of board meeting**
  - **Right (duty) to attend board meeting**
  - **Be prepared for meetings**

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- **Management access and control over the affairs of the corporation**
  - Directors are responsible for all aspects of operations of the corporation
  - Directors must be proactive in management and not be limited to setting policy only
  - Directors have right of access to property of corporation and to inspect and copy books, corporate records and other documents

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- **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
- **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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**2. 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**
- **Ensure policy is followed**

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**3. Training/education**

- **Directors should maintain their skills and knowledge in the area of the corporation'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**

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**4. Fundraising – Charities**

- **Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts and other applicable disbursement quotas**
- **Monitor fundraising appeals and understand the obligations of directors with respect to appeals that result in restrictive gifts**
- **Ensure gifts are used for charitable purposes**
- **Review and enforce terms of restricted and endowed gifts**

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**5. Reliance on Professional Advice**

- **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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**6. Utilizing due diligence checklists**

- **Legal Risk Management Checklist**
- **Sexual abuse checklist**
- **Fundraising compliance due diligence checklist**
- **Insurance checklist**

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**UNDERSTANDING THE DUTY OF CARE**

- Directors of all corporations must exercise certain standard of care in carrying out duties
- Standard of care varies depending on type of corporation and incorporating statute
  - Business corporation
    - Statutory objective standard of care: Reasonably prudent person
    - Directors need to ask: How would a “reasonably prudent person” conduct the affairs of the corporation?

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- Not-for-profit corporation (non-charity)
  - Common law subjective standard of care
  - Director’s own knowledge and experience important
  - Directors need to ask: What level of skill and care can reasonably be expected from a person with my knowledge and experience?

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- Charitable corporation
  - Additional expectations beyond subjective standard
  - Courts in Ontario have held that directors of charities also subject to fiduciary duties as quasi-trustees of charitable property
  - Directors need to ask: What level of care would a reasonable and prudent person managing his own affairs exercise?

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**DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION**

- **Protection from third party contractual liability**
  - Protection available for corporations under the s. 21(3) and 157(1) *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**
  - Common law rule prohibits directors from being in a 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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**INDEMNIFICATION AND INSURANCE**

- **Statutory Basis for Directors and Officers insurance and Corporate Indemnity**
- **Federal and Ontario corporate statutes now permit corporate indemnity and Ontario permits purchase of director and officer insurance**

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- **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?**

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- **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 corporation**

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**OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK**

1. **Legal Risk Management Committees**
  - **Legal risk management committee should 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. The Board in Operation

- Record dissents of directors
- Require treasurer’s reports at every meeting with respect to statutory remittances for which directors have liability

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5. Committees and Advisory Boards

- Committees and advisory boards can be an effective means of attracting volunteers without the risk of being directors but ensure that functions are advisory
- Individuals committee members could run the risk of liability where decision making really at level of a committee
- Board of directors must always remain in control

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6. 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 should ideally be done before becoming a director so as not to defeat claims of creditors

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Affiliated with Fasken Martineau DuMoulin LLP

Main Office • Orangeville, Ont  
Ottawa Office:  
70 Gloucester Street  
Ottawa, ON K2P 6A2  
Tel: (613-233-2672)

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