Risk Management

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Risk Management is...

“...the discipline for dealing with the possibility that some future event will cause harm. It provides strategies, techniques and an approach to recognize and confront any threat or danger that may hinder the organization from fulfilling its mission.”

- Alliance for Nonprofit Management (2001b)

Three Aims:

- Prevention
- Minimize Harm
- Liability Reduction
Risk Management Myths:

- Risk Management = Insurance
- Risk Management is just for managers
- Risk Management is an add-on to the things we're already doing

Risk Management & BBBS:

- National Committee formed in 2004
- Workshop delivered at National Convention June 2005
- Risk Identification Checklist has been drafted

Risk Management Cycle:

Source: "Better Safe...Risk Management In Volunteer Programs & Community Service" by Linda L. Graff
Risk Management Model:

Source: "Better Safe ... Risk Management In Volunteer Programs & Community Service" by Linda L. Graff

Classifications of Risk:

- People
- Property
- Income
- Goodwill
- Liability
- Mission Effectiveness

Overview – Legal Liabilities

- General overview of sources of liability
- Specific example: Fundraising
- Operational due diligence
A. Liability of Directors and Officers

1. 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
   - Directors and officers need to ask: What level of care would a reasonable and prudent person managing his own affairs exercise?

2. Common Law Duties and Liabilities
   - Management of the Corporation
     - Directors are responsible for all aspects of corporations operations
     - To fulfill duties, directors must ensure:
       - Objects are properly carried out and activities comply with objects
       - Corporation’s financial stability and overall performance
       - Proper hiring and supervision of management and staff
     - Failure to act can result in personal exposure to liability i.e. liability of Worldcom directors

- Liability Risk for Lack of Corporate Authority
  - Corporate authority defined by corporate objects in governing documents
  - All corporate activities must fall within parameters of these objects
  - Liability results where directors act outside scope of this authority
- **Liability Risk for Negligent Mismanagement (Tort)**
  - Tort is civil wrong for which injured party can seek damages from the court
  - Directors can be personally liable for corporation’s torts where own conduct or inaction contributed to victim’s injury

- **Liability Risk in Contract**
  - Directors generally not personally responsible for contracts signed for corporation
  - However, need to have proper corporate authority to sign contracts and ensure contractual terms are complied with

- **Liability Risk for Breach of Fiduciary Duty**
  - Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property
  - Directors of not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest
  - Fiduciary duties owed to charitable objects, corporation, donors, members and creditors

**Summary of fiduciary duties**
- Duty to act honestly
  - Conflicts of interest to be avoided and disclosed
  - Directors must not act fraudulently
- Duty of loyalty
  - Director’s sole interest is to the corporation
  - Director’s interests not to be placed in conflict with those of corporation
Duty of diligence/duty to act in good faith
- Directors to diligently attend to duties by being familiar with all aspects of corporation
- Directors may have liability exposure at common law for failure to attend to their legal duties or those of the corporation
- Where necessary, advice of qualified professionals should be sought

Duty to exercise power
- Directors responsible for managing corporation

Delegation to management, staff and volunteers is possible, but directors must always supervise

Duty of obedience
- Directors must comply with applicable legislation and the corporation’s governing documents
- All valid corporate decisions must be implemented

Duty to avoid conflict of interest
- Conflicts of interests to be avoided
- Directors must also avoid anything that gives director appearance of a personal benefit
- Where conflicts occur, they are to be declared, director to not participate in discussions or vote, and may even have to resign
Duty of prudence
- Directors with special expertise must use it prudently to achieve best result for corporation

Duty to continue
- Resignation as director will not relieve all obligations
- May even constitute breach of trust
- Independent legal advice should be obtained in considering resignation

Liability for Breach of Trust
- In addition to fiduciary quasi trustee duties, directors of charitable corporations may also be trustees of some charitable property
- However, fiduciary duties and trustee duties essentially the same

3. Statutory Duties and Liabilities
- Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
- Directors can be held personally liable, as well as jointly and severally, with other directors
- Only defence is due diligence
- Resigning as a director may not limit liability though there are generally limitation periods
B. EXAMPLE: LEGAL RESPONSIBILITY OF CHARITIES AND DIRECTORS IN FUNDRAISING

- Improper or negligent actions by development officers or fundraisers could expose a charity and its directors to legal liability
- The court held in The Aids Society for Children (Ontario) that
  - Although a charity does not hold its charitable property in trust for its charitable purpose, a charity has a fiduciary obligation to apply donations for its charitable purposes

- A fiduciary has a legal obligation to put the interests of others ahead of the interests of the fiduciary
- There is little practical distinction for directors between being a trustee and having fiduciary obligations
- A charity and its directors have a fiduciary obligation to account to the public for all funds raised from donors
- Charities and directors therefore have a fiduciary obligation to donors to ensure that donations are applied for the charitable purposes of the charity

- It is essential for charities and their directors to review charitable objects on a regular basis and amend those objects as necessary
- Third party fundraisers and sub-contractors are agents of the charity and may cause liability for both the charity and its board of directors personally
- Fundraising contracts which provide for unreasonable compensation may be voidable based upon both violation of public policy and/or misrepresentation
- Misrepresentation is determined by the perception of the donor, not by intent of charity or its directors in receiving the gifts.
- The fiduciary duty of a charity and its board of directors to account for donations applies to the gross amount of donations raised by third party fundraisers, not to the net amount that the charity may be entitled to pursuant to a fundraising contract.
- Fundraising costs of between 70% to 80% renders the contracts void as being contrary to public policy.

- The directors were found personally liable for unreasonable fundraising costs in the amount of $766,000.
- Fundraising companies were required to repay unreasonable fundraising costs.
- The directors were subjected to a penalty of $50,000.00 under the Charities Accounting Act (Ontario).
  - The court in National Society for Abused Women and Children confirmed.
  - Fiduciary obligation of directors to account for unconscionable fundraising costs.

- Fundraising contract was declared void abinitio as being contrary to public policy.
- Donors are entitled to know about fundraising and administrative costs when making donations.
  - For more information on these cases, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca.
  - The “buck” stops with the board of directors of a charity after everyone else has left the charity.
  - The board of directors must therefore be made familiar with all fundraising programs and the liabilities associated with those programs.
Legal liability in fundraising can be reduced by developing a proactive legal risk management approach to fundraising.

Fundraising must comply with the applicable corporate objects and powers of the charity:
- The fundraising program must not be *ultra vires* the charitable objects of the charity.
- The charitable purpose being furthered by fundraising must not be *ultra vires* the charitable objects.
- A donor restricted gift resulting from fundraising must not be *ultra vires* the charitable objects.

Fundraising must not violate applicable statutory provisions:
- Selected specific charitable statutes affecting fundraising in Ontario:
  - *Charities Accounting Act* (Ontario)
  - *Charitable Gifts Act* (Ontario)
  - *Religious Organizations Land Act* (Ontario)
  - *Income Tax Act* (Canada)

General exposure to liability involving donors:
- Misrepresentation involving issuance of charitable receipts and/or the amount.
- Failure to comply with donor restrictions.
- Failure to disclose excessive fundraising costs.
- Detrimental reliance upon charitable endorsements.
- Detrimental reliance upon improper tax advice involving donations.
- Breach of fiduciary duty and/or breach of trust in applying funds to charitable purposes.
Donor’s statutory rights
- Charities Accounting Act (Ontario)
  - Section 6 of the CAA (public inquiry)
  - Section 10 of the CAA (alleged breach of trust)
  - Section 4(d) of the CAA (non-compliance with donor directions)
  - Section 3 of the CAA (formal passing of accounts)
- The Income Tax Act (Canada)
  - Informal complaint to CRA
  - Resulting audits
  - Receipting and disbursement violations

C. OPERATIONAL DUE DILIGENCE

- Decisions are made by the Board of Directors and not by individual directors or groups of directors
- Decisions are articulated through resolutions
- Once decisions are made, the “corporation” has spoken through the Board - this is the concept of “corporate authority” of directors

Operational due diligence requires directors to exercise due diligence on all levels of operation and in a pro-active manner

1. 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
2. Directors should understand their rights/obligations at board meetings
   - Right (duty) to attend board meeting
   - Directors must be prepared for meetings
   - Directors have equal voting rights
   - Need to record contrary vote
   - Must declare conflict of interest

3. Directors should carry out their duties in a way which reflects their ultimate responsibility for corporate operation
   - Directors should be proactive in management
   - Directors have right of access to property of corporation and to inspect and copy books, corporate records and other documents
   - Directors have a fiduciary duty to protect charitable assets

4. The board should establish policy
   - A policy is a governing principle. It allows the board to delegate to others (staff, volunteers, agents) the authority to act on behalf of the organization
   - Board control over the implementation of a policy is essential
   - Policy allows staff, volunteers, agents and others to know what the board wants and expects and why
5. Directors should seek out and take advantage of training/educational opportunities and ensure participation by senior staff:
   – In the area of the corporation’s current operation
   – Changes in the law affecting directors’ duties
   – Corporate and tax laws affecting organization

6. Directors of charities should monitor and require reports regarding fundraising program and compliance with ITA obligations
   – Monitor fundraising appeals
   – Understand director obligations regarding restricted gifts
   – Review and enforce terms of restricted and endowed gifts
   – Ensure gifts are used for charitable purposes

7. Directors are entitled to and should rely on advice
   – Internally (Management)
     ◆ Except in very small organization, directors will generally need to engage a staff person or manager to oversee operations
     ◆ Directors should receive and review reports from management at every board meeting
   – Externally (Outside professionals)
     ◆ Relying on professional advisors like accountants and lawyers provides evidence of due diligence
8. It can be helpful for boards to use due diligence checklists
   - Legal Risk Management Checklist
   - Sexual abuse checklist
   - Fundraising compliance due diligence checklist
   - Insurance checklist

Evaluating Risks:
- Likelihood of Occurrence (low, medium, high)
- Magnitude of Harm (low, medium, high)

Risk Priority Mapping:

Source: "Better Safe...Risk Management In Volunteer Programs & Community Service" by Linda L. Graff
Risk Action List/Plan:
- Risk Priority Map determines your action list and risk priority levels
- These are used to develop your Risk Management Action Plan
- Implementation and ongoing risk management monitoring

Resources & Links:
- www.charitylaw.ca
- Alliance for Nonprofit Management – www.allianceonline.org
- Linda Graff & Assoc. – www.lindagraff.ca
- CSAE – www.csa.com
- Volunteer Canada – www.volunteer.ca
- www.nonprofitrisk.org

Thank you!
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