THE JOHN MCININCH FOUNDATION

MCININCH SYMPOSIUM ON RISK MANAGEMENT

Where It All Starts: Governance and Fiduciary Risk
Toronto – November 23, 2007

Part II
Due Diligence in Avoiding Liability for Directors and Officers of Charities and Not-for-Profits

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent

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A. OVERVIEW OF TOPICS

- **Due diligence through good governance**
- **Due diligence in the choice of organizational structure**
- **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 Summary "B" entitled "Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits". 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 THROUGH GOOD GOVERNANCE

- **Developing a mission and strategic plan**
  - **Ensure that the mission statement is consistent with corporate objects**
  - **Do periodic reviews of both**
- **Ensure transparency and communication**
  - **communicate to members, donors and the public**
  - **Focus on ensuring accountability**
- **Maintain organizational structure**
  - **Be knowledgeable of corporate structure**

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- Letters patent
- By-laws
- Special resolutions
- Policies

– **Be prepared to change corporate structure as necessary to better reflect programs undertaken**

- **Understand the role of the board**
  - **Continually educate board members**
  - **Develop conflict of interest and code of conduct policies**
  - **Prepare a board manual**

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- **Exercise fiscal responsibility**
  - **Establish and maintain a budget**
  - **Monitor all fiscal expenditures and/or commitments**
  - **Monitor human resources**
  - **Review and approve all fundraising and initiatives and donation receipts**
- **Plan for the diversity and succession of the board**
  - **Determine specific needs of the board and recruit in accordance with those needs**
  - **Plan for an orderly succession of directors**

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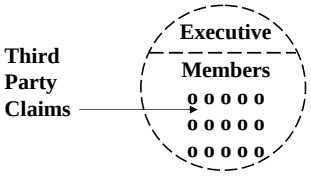
C. DUE DILIGENCE IN THE CHOICE OF ORGANIZATIONAL STRUCTURE

- **Charities and Not-for-Profits as Unincorporated Associations**
  - **Not a legal entity**
  - **Generally used for starting up a charity or not-for profit in its early stages**
  - **Flow through liability to members**



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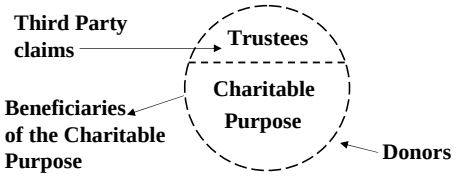
- **Charities as Charitable Trusts**
  - **A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property**
  - **Available for charitable organizations, public foundations and private foundations**
  - **Trustees are exposed to liability**



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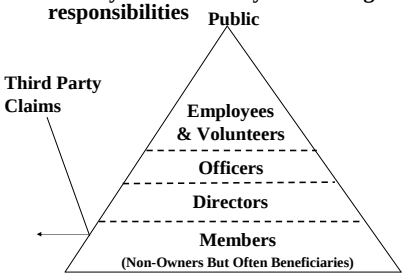
- **Charities and Not-for-Profits as Corporations**
  - **Separate legal entities**
  - **Members are not exposed to liability**
  - **Directors may be still exposed to personal liability from fiduciary and management responsibilities**



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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**
  - **Multiple charitable corporations can include**
    - **Parallel foundations**
    - **Parallel operating charities**
    - **Umbrella organizations**

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- **Parallel foundations have become more common in protecting long term gifts and endowment funds as a result of recent case law**
- **Need to give consideration to balancing control of multiple corporations with issues involving the possibility of cross over liability?**
- **Need integrated corporate structure and trade-mark licensing to avoid loss of control**
- **Need to give consideration to implementing effective control through contracts and/or licensing agreements as an alternative to overt corporate control?**

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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 a 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**
  - **The reverse is also a risk: top-tier corporations can lose control over subsidiaries without proper corporate control in place and/or appropriate agreements**

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- **Are relationships with national organizations and/or subsidiary chapters adequately documented to protect the rights of both parties?**
- **Are relationships between national and international structures adequately documented with specific reference to controlling trademarks in Canada?**
- **Is there need for an international umbrella organization?**
- **Has the ownership of trade-marks and/or copyrights been determined and protected and licensed in Canada?**

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D. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- **It is important for directors and officers to know what statutory defences are available to them**
- **Protection from third party contractual liability**
  - **Protection available for corporations under the current *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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E. 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 for certain activities**
  - **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**
- **Proactive 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 *Trustee Act* (Ontario)**
- **Need to take an inventory of charitable assets**
  - **Review annual financial statements**
  - **Review bank statement and records**
  - **Review past and current restricted funds**
  - **Review property deeds, if applicable**
  - **Review intellectual property, if applicable**
- **Notice/attendance at meetings/minutes**
  - **Right to notice of board meetings**
  - **Right to attend board meetings**

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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 Pursuing 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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- **Utilizing 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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F. 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 results 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 and its insurance**

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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- **Additional 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?**
  - **Are there exclusionary clauses that limit the protection offered by the policy, such as sexual abuse?**
  - **Is coverage on a "claims made basis" or on an "occurrence basis"?**

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  - **Are there geographical limits to the coverage?**
  - **Insurance may 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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G. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK

1. Legal Risk Management Committees

- **Legal risk management committee needs to be formed to conduct review and identify risks**
- **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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