
THE 2006 ANNUAL CHURCH & CHARITY LAW™ SEMINAR

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Navigating a CRA Audit and Living to Tell the Tale

By Karen J. Cooper, LL.B., LL.L., TEP

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OVERVIEW

- Background
- Pre-audit Considerations
- Audit Process

For more information see article entitled "Regulatory Regime - New rules seen as consistent with recommendations of VSI" at <http://www.canadianfundraiser.com/newsletter/article.asp?ArticleID=1792>

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BACKGROUND

- New rules concerning the taxation and administration of charities are now in force:
 - New intermediate sanctions and penalties
 - New appeals process
 - Also new DQ rules and increased transparency

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- **Budgets brought increased resources to the Charities Directorate at CRA**
- **Increasing number and scope of audits performed by auditors in local TSOs**

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PRE-AUDIT CONSIDERATIONS

- **An audit is inevitable**
- **To be forewarned is to be forearmed**
- **The best protection is knowledge and adequate books and records**
- **“Perfection is not expected or required” - unfortunately, experience is showing otherwise**

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1. Knowledge

- **Attend seminars and other educational opportunities**
- **Registered Charities Newsletters**
- **Charitylaw.ca**
- **<http://www.cra-arc.gc.ca/tax/charities/>**

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- **Likely audit issues:**
 - Books and records
 - Receipts
 - Charitable activities vs private benefit
 - Political Activities
 - Related Business
 - Agency agreements
 - Operating outside Canada
 - Disbursement quota
 - Fundraising revenues and expenses
 - Remuneration/Undue benefit

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- Charities need to know and understand their obligations with respect to these issues before being able to ensure compliance
- Ignorance will not be a defence
- Document uncertainty and steps taken to seek clarification

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- 2. Adequate Books and Records**
- Charities will be required to produce the following:
 - Copies of T3010s, as filed with attachments
 - Financial statements
 - Books and records (general ledger, cash receipt/disbursement journals, working papers)
 - Listing of bank accounts with all statements, cancelled cheques and deposit books

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- Listing of all cash donation receipts including the receipt number, name of donor, and amount reconciled to the financial statements and bank deposits
- Listing of all gift-in-kind donation receipts including the receipt number, name of donor, description, FMV of property, eligible amount. For gifts which were appraised (over \$1,000), name and address of appraiser, who/how appraiser was selected, and what information was compiled before accepting the appraised value

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- Duplicates of all receipts
- Reconciliation and breakdown of expenditure reported (line 120/5000 of T3010)
- All expense source documentation (contacts, invoices, receipts, statements, cancelled cheques)
- Note: instructions to auditors require that the source documentation must be in the name of the Charity for the expense to be allowed, particularly if meeting & accommodation, meals or entertainment
- Details of the charity's activities supported by copies of brochures, pamphlets, publications, membership and fundraising correspondence, newsletters, etc.

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- Governing documents, i.e. Constitution, Letters Patent and Supplementary Letters Patent, By-Laws
- Official updated Minute Book
- Listing of Directors/Trustees, their positions, occupations, relationship to others, details of any remuneration or other compensation received (including reimbursement of expenses)
- Payroll documentation (T4s)
- Agency/consulting agreements

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3. Other strategies

- **Ensure that Board approval is obtained for changes to charitable programs and consider obtaining CRA approval**
- **Review charitable objects regularly and provide CRA with changes to governing documents**
- **Review and comply with document retention requirements**
- **Consider obtaining Board approval of T3010s**

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- **Comply with receipting requirements**
- **Avoid excessive salaries, fundraising contractors and fees (document due diligence and comparisons)**
- **Grants to foreign charities – ensure appropriate agency agreements are in place**
- **Protect privileged documents (communications related to obtaining legal advice, does not include accountants or consultants)**

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AUDIT/APEALS PROCESS

CRA's Progressive Approach:

- 1. Education (specific and general)**
- 2. Compliance Agreements**
- 3. Intermediate Sanctions**
- 4. Revocation**

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Steps in the Audit/Appeals process:

- 1. Organization is identified for audit**
 - Random selection
 - Legislative criteria/concerns
 - Follow-up on non-compliance or complaints
 - Audit of related organization
- 2. Office Audit - File is screened by Charities Directorate (entails a desk review of information on file with CRA and internet) and, if necessary, referred for a field audit**

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CHECKLIST – CHARITY AUDIT PROGRAM

- I. Objects and activities**
 - * Political Activities
 - * Business Activities
 - * Agency Agreements
 - * Operating Outside Canada
- II. Official donation receipts**
 - * Gifts in kind
 - * Tuition Fees

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- III. Revenues (Other than receipted revenues)**
- IV. Disbursement Quota**
- V. Expenditures on Charitable Activities**
- VI. Fundraising revenues and expenses**
- VII. Other expenditures**
 - * Remuneration
- VIII. Current Assets**
- IX. Investments/Fixed assets**
- X. Liabilities**

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3. Field Audit

- On location
- Single or a team
- Examination of books and records relating to bank accounts, investments, expenses, contracts, annual reports, board minutes, and any other documents related to the charity's activities
- Not only an examination of financial affairs, also an examination to determine compliance with legal obligations under the ITA and if operating for charitable purposes
- Consider engaging counsel at this point

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Audit Day

- The auditor is not your friend (or enemy)
- ITA 231.1 requires “all reasonable assistance”
- Disclose only required information
- Be responsive
- Make auditor comfortable
- Consider requesting written questions
- Document/demonstrate efforts to comply

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4. Audit Report is prepared

- Quite often preliminary findings will be communicated in advance to the charity
- Key document for the organization to obtain because it details the audit findings and the legal basis of any assessment of sanctions
- Consider requesting copies of the auditor's working papers

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5. Letter to charity advising of results

- **Education – minor non-compliance**
- **Compliance Agreement (formerly undertaking letter)**
 - **Corrective action required: agreement outlines non-compliance and remedial actions that the charity must undertake and includes a paragraph that advises the charity that a penalty and/or suspension could apply if the agreement is not upheld**

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- **Formal document signed and dated by both parties, includes a timeframe to make changes outlined in the agreement**
- **Before signing compliance agreement, consider seeking professional advice from a lawyer with respect to the issues raised in the compliance agreement**
- **Obtain Board approval**

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- **Administrative Fairness Letter**
 - **Preliminary to revocation**
 - **Advise Board**
 - **Obtain professional advice from a lawyer as soon as possible to protect limitation periods – usually given only 30 days to respond before Notice of revocation is issued**

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6. Follow-up

- CRA may bring file forward for automatic review to ensure compliance with the agreement
- May be by office or field audit
- If compliant, file likely closed
- If non-compliant, maybe application of interim sanctions

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7. Application of Interim Sanction/Penalty

- Sanction Assessment letter
- Make payment to CRA or an eligible donee (another arm's length charity) and return sign off form to CRA once payment has been made
- Appeal

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8. Revocation

- Still available for any offence at any time and can be applied with intermediate sanctions
- The charitable status of a charity may also be revoked if it obtained its charitable registration on the basis of false, misleading or omitted information

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- **Charitable registration deemed revoked effective on the date of Notice of revocation**
- **Liability for revocation tax payable within one year of date of Notice**
- **Valuation precedes date of Notice by 120 days**
- **Beware of appropriations of charitable property during winding-up period**

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9. Internal Appeal

- **Must file a Notice of Objection with the Assistant Commissioner of CRA's Appeals Branch within 90 days of the date of the decision's mailing**
- **Reviewed by an officer in the Appeals Branch of CRA, separate from the Charities Directorate, and the officer will have the authority to maintain, vary or disagree with the original decision**
- **Notice of objection is required before an appeal may be brought to the Courts**
- **Objection will rarely delay revocation**

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10. Court

- **Tax Court: appeals of intermediate sanctions and penalties**
- **Federal Court of Appeal: application for judicial review of refusals to register, revocation, annulment, and charitable designation**

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