

The 2001 Annual *Church & the Law* Seminar

November 6, 2001

The *Charities Accounting Act* Recent Changes and Court Decisions: The Impact on Religious Charities

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This paper will look at recent legislative developments under the Charities Accounting Act and a recent court decision and will cover the following:

- 1. Regulation under the *Charities Accounting Act***
 - (a) Indemnification of Directors and Officers and the Purchase of Liability Insurance**
 - (b) Combining Special or Restricted Purpose Trusts Funds**
- 2. Investments by Trustees and Directors of Charities**
- 3. Fundraising and the AIDS Society for Children (Ontario) Case.**

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I Regulation under the *Charities Accounting Act*

- Ontario Regulation, O. Reg. 4/01, was effective January 17, 2001.
- Authorizes:
 1. Purchase of directors and officers liability insurance;
 2. Indemnification of directors and officers for liability incurred as a director or officer of a charitable corporation;
 3. Combining special or restricted purpose funds for investment purposes.

Indemnification of Directors and Officers and the Purchase of Liability Insurance.

- At common-law directors and trustees of charities required a court order before they could indemnify themselves or purchase liability insurance because the expenditure could be considered a personal benefit and prohibited by the conflict of interest rules.
- This regulation is permissive not mandatory and allows a charity to decide if they wish to indemnify directors, officers and trustees or to purchase directors or officers liability insurance.
- Any indemnification or liability insurance can only cover losses where the directors, officers or trustees act in good faith.
- The regulation sets out factors to be considered before providing an indemnification or purchasing liability insurance that include whether it makes good business sense and whether it will benefit the charity.
- No court order is required provided the conditions contained in the regulation are followed.

Combining Special or Restricted Purpose Trusts Funds

- These are donated funds which are to be used for a special purpose as opposed to the general expenses of the charity. An example is where money is given to purchase and maintain a stain glass window.
- Before the regulation, all special purpose funds were to be held separately even for investment purposes.
- Under the regulation special purpose funds can now be combined for investment purposes as long as the conditions in the regulation are followed.
- Special purpose funds can only be combined if it is in the best interest of all the funds combined.
- Special purpose funds and general purpose funds can not be combined.
- In addition to existing record keeping requirements a charity must maintain complete records, as set out in the regulation, for each special purpose fund and also for the combined special purpose trust.

See O. Reg. 4/01 and Charities Bulletin #7 for more information.

II Investments by Trustees and Directors of Charities

- Amendments to the *Trustee Act*, effective July 1, 1999, changed investments from an approved list of investments to the prudent investor standard, that is investments that a prudent investor might invest in.
- Amendments to the *Trustee Act*, effective June 29, 2001 now allow trustees to delegate investment decisions subject to conditions set out in the *Act*.
- These provisions apply to charities that are set up as trusts and under section 1.1 of the *Charities Accounting Act* they apply to incorporated charities.
- Trustees and directors of an incorporated charity must meet three conditions to allow delegation of investments to an agent:
 1. have a written investment plan or strategy;
 2. have a written agreement with the agent, and
 3. exercise prudence in selecting the agent, establishing the terms of the agent's authority and monitoring the agent.
- If there is a loss and the loss is a result of the agent's breach of duty, an action can be started against the agent to recover the loss. The action can be commenced by the trustee (directors of an incorporated charity) or the

beneficiaries of the trust if the trustee does not bring the action within a reasonable time.

- The amendments do not allow delegation if this would be contrary to the terms of the trust or documents creating the incorporated charity (i.e. its Letters Patent).

See *Trustee Act* sections 26 to 30 and in particular sections 27.1 and 27.2 for delegation of investment powers; section 1.1 of the *Charities Accounting Act* and *Charities Bulletin #7*.

III Fundraising and the AIDS Society for Children (Ontario) Case.

- The AIDS Society for Children (Ontario) (the “Society”) was an incorporated charity, operating in several cities in Ontario. The Society was also registered with Revenue Canada (now Canada Customs and Revenue Agency) as a registered charity. Its objects were to build hospices for children with AIDS.
- The Office of the Public Guardian and Trustee (“OPGT”) received complaints about the operation of this charity, in particular that it was not using the funds it raised to meet its charitable objects.
- The OPGT requested the charity to pass its accounts (this is a financial audit by the courts). When the charity did not pass its accounts the OPGT commenced court action under the *Charities Accounting Act*.
- The Society had hired two professional fundraisers to raise funds for the charity. The court also ordered the fundraisers to pass their accounts.
- A review of the accounts showed the followings funds collected from the public:

The Society collected-	\$546,000,
The fundraisers collected-	\$375,000,
For a total amount of-	\$921,000.
- The fundraisers spent \$296,000 on their fees and expenses being 80% and 76% of the funds they collected.
- The Society received from all sources \$622,661.57 and all of this money was used for its fees and expenses. Nothing was spent on pursuing the charity’s objects.
- Before the Court could deal with the passing of accounts a number of legal issues needed to be dealt with:
 1. What is the relationship between the Society, the fundraisers, the individuals working for the fundraisers and the individual donors?

2. What funds need to be accounted for i.e. the gross amount paid by the donors or only the amounts actually paid to the Society, and who is responsible for accounting for these funds?
 3. Is all or part of the fundraising agreements void or voidable?
 4. Did the Society offend the 80/20 rule of the *Income Tax Act* (Canada) and if it did what affect would this have on the fundraising contract?
- While the charity, its directors and the two fundraisers were served, only the OPGT participated in the motion. The court noted that the issues were presented in as neutral a manner as possible.
 - This court released its decision May 25, 2001. It held that charities and those who run charities are responsible to the public for all funds collected from the public. This applies even if professional fundraisers are hired. This is the case even if the charity is incorporated.
 - The fundraisers are not accountable to the public, but must account to the charity, for all money received, even if the canvassers are independent contractors and not employees of the fundraiser.
 - Although the courts have been reluctant to interfere with the right to contract, fundraising contracts can be set aside in certain circumstances based on public policy considerations or misrepresentation to the public. The former could include contracts that provide for unreasonably high fundraising costs.
 - It may be possible that the court may hold trustees and directors responsible for unreasonable expenses.
 - While the court did not set out what were reasonable expenses, the court did find that expenses of 70% or greater were unreasonable.
 - When a charity is involved in fundraising it needs to make sure that the costs are reasonable; that there is full accounting of all funds received and all expenses. Charities should be involved and oversee all fundraising even if it hires professional fundraisers.
 - It is important to note that the Judge made no finding of facts and did not set aside any of the contracts with the fundraisers. The consequences of this decision will not be known until the court deals with the actual passing of accounts.

TEN TIPS

1. **Know your constating documents.** These are the documents that set up the charity such as a trust document, constitution or letters patent. These documents describe the objects the charity can undertake and set out the powers and any limitations on those powers.
2. **Document your deliberation, decisions and actions.** Show you have considered any legislative requirements i.e. to purchase liability insurance or when establishing an investment plan.
3. **Keep a record of your financial transactions.** These include the records required by regulation O. Reg. 04/01 to allow for the combining of special purpose trust funds or showing the results of your fundraising campaigns.
4. **If you have funds to invest or have a fundraising campaign, have a plan.** This should be a full detailed plan in writing.
5. **When agents are hired, including agents to invest the charity's funds or to fundraise, have a written agreement, which clearly sets out the responsibilities and liabilities of all parties.**
6. **Creating a plan and entering into agreements are not enough. You must continue to monitor and evaluate your plans and agreements.**
7. **If directors or trustees use agents i.e. for fundraising or investments, they remain responsible for the agents actions. Therefore if your monitoring and evaluating shows action is required, take appropriate and timely action.**
8. **Be knowledgeable about the assets of the charity. Are there any special purpose funds?, and if there are, what are the restrictions on using these funds? Be aware of any conditions that maybe attached to any funds donated to the charity. These conditions can affect not only the purpose of the funds but also how the funds can be invested.**
9. **Know your duties, responsibilities and powers as a director or trustee of a charity. You need to be actively involved in the charity's decision making process. You need to act in the best interest of the charity making sure the charity operates effectively and within the law. This includes using the charities assets only for the purposes (objects) that the charity is authorized to do.**
10. **Be informed. Check out the Charities Bulletins at www.attorneygeneral.jus.gov.on.ca. These Bulletins provide basic information about charities but are not a substitute for legal advice. For advice consult your legal advisor and other knowledgeable advisors.**