



## Chapter 6

# Legal Risks and Liabilities





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This is an area of concern and potentially a dangerous area for volunteer directors who assume the responsibilities incumbent on them without:

1. Fully understanding the position directors play in the Chamber; and,
2. Fully understanding the responsibility that lies on the shoulders of directors.

There is a pronounced social and legal trend towards a higher standard of performance for persons in positions of responsibility and for persons holding themselves out as experts. There is also a trend towards more generous awards to plaintiffs in negligence actions.

## Introduction

### What are Directors?

The term **director** means a person who is **elected or appointed by the members to manage and direct the affairs of the Chamber**. This includes the officers, members of the board, and a person occupying any such position by whatever name called.

By accepting the position of director, he/she is a decision-maker assuming **responsibility** for the administration of the Chamber, its assets, its liabilities, its contracts, and its overall policies.

### Appointment of Directors

1. The members of a Chamber may in accordance with the bylaws of the Chamber nominate, elect, and appoint directors. There are other means of appointment of directors (should be outlined in the bylaws).
2. Under certain circumstances, existing directors may appoint further directors.
3. In both the above cases, the person appointed as a director must consent to such appointment and in most instances this must be in writing.
4. In certain Chambers, there is provision by statute or through the bylaws and constitution, for the appointment as directors certain persons who hold positions in the community (i.e. the mayor or reeve).

## Legal Duties of Directors

The duties of the directors are extremely important and you should note them carefully. A director **WILL**:

- A. Act honestly and in good faith and in the best interest of the Chamber; and,
- B. Exercise the care, diligence, and skill of a reasonably prudent person in exercising his/her powers and performing his/her functions as a director.

Below are some of the definitions the courts have given common terms;

1. **Honest** — in their dealings with fellow directors, directors must tell not only the truth, but also the whole truth;
2. **Duty of Care** — the duty of care requires prudence and diligence;
3. **Duty of Diligence** — diligence is making those enquiries, which a person of ordinary care in his/her position or in managing his/her own affairs would make. Directors rely on officers, outside experts, and other directors at their own risk;
4. **Duty of Prudence** — the duty of prudence requires directors to use common sense. Acting prudently is acting carefully, deliberately, and cautiously in trying to foresee the probable consequences of the Act; and,
5. **Duty of Skill** — at common law, a director is not required to exercise a greater degree of skill than can reasonably be expected from a person of his/her knowledge and experience. Directors are not liable for mere errors in judgement.

***There is absolutely nothing that can be contained in a contract or in the constitution or bylaws that relieves a director from these duties.***

You may be interested in noting the difference between the duties of a director in a corporation as compared to the duties of a director of a non-profit organization. On a board of a non-profit organization you assume additional, rather than different, responsibilities to those of a director of a profit-oriented enterprise.

The legal responsibilities are the same for both types of organizations. The nature of most non-profit organizations, however, complicates the responsibilities and liabilities of the director. *"The market pressure and profit measures disappear when you enter into the world of non-profit organizations."*

The measure of achievement depends upon the nature of the organization, but generally relates to subjective values on opinion-oriented matters such as: *the provision of quality education and, service to the community*, etc. You can appreciate the difficulty in comparing a measurement of simple profit of monies as compared to these more subjective valuations.

## Legal Risks and Responsibilities

The following constitute the **10 main areas of legal risk**:

1. **FUNDS** — the administration of monies, the approval of expenditures, budgeting, and preventing fraud — a director should not become involved in the detail, but must satisfy himself/herself an adequate system exists for the control of funds. You must rely on your auditors.

2. **EMPLOYEES' WAGES** — there is a statute called the Payment of Wages Act, under which directors are personally liable for up to two months' wages of unpaid employees in the event that the Chamber becomes insolvent.

3. **NEGLIGENCE OF EMPLOYEE** — this is known as "tort" liability.

Common examples are:

- a. Accidents caused by the negligent operation of a motor vehicle; or,
- b. The negligence maintenance of the Chamber's premises.

These are items the director should be made aware and confident that there is adequate insurance.

4. **CONTRACTS** — who can commit the Chamber or its members to expenditures and obligations under contracts? This should be clearly defined in the bylaws and procedures of the Chamber.

- a. Basically, if the organization is incorporated, there is a "legal entity" for a plaintiff to sue. If the organization is unincorporated the plaintiff is more likely to sue the individuals involved in the contract as well as the directors of the organization.
- b. Incorporation consists of filing a constitution and bylaws under the Societies Act (provincially) or Boards of Trade Act (federally), who will issue a certificate creating the legal entity. This entity exists independently of its members and can sue and be sued, can enter into contracts and has an indefinite life span.
- c. An unincorporated organization may be highly organized with a detailed constitution and bylaws or may be totally unorganized.
- d. The executive of an organization has no authority to pledge the credit of the members by entering into a contract unless such authority is expressly or impliedly granted through the bylaws or some other way.

In particular consider leases of premises, leases of office equipment, and other common commercial contracts. Again, the director must satisfy themselves there is a system in place to have contracts analysed and approved before being signed.

5. **DISCLOSURE OF INTEREST** — a director of a Chamber has a duty to disclose any interest, whether direct or indirect, in a proposed contract or transaction with the Chamber.

6. **THE ASSETS OF THE CHAMBER** — buildings and equipment — these assets are subject to damage or loss, and the director should be satisfied and aware that the assets are properly insured.
7. **STARTING UP A SOCIETY** — where a Society has less than three members for more than six months, each director is personally liable for the payment of every debt of the Society incurred after the expiration of six months and for as long as the number of members continues to be less than three.
8. A director may delegate his **authority** to paid staff members, but he **CANNOT DELEGATE HIS RESPONSIBILITY**. If the staff creates the liability, the directors or the Chamber must answer. For example, a director who signs a cheque cannot say he did so as an administrative act or rely on a co-signer. He accepts full responsibility.
9. **NON-COMPLIANCE REGARDING FILINGS, TAXES, OR OTHER GOVERNMENT REQUIREMENTS** — a director is potentially liable to members, third parties such as contractors or victims of negligent acts, and the various levels of governments for non-compliance by the Chamber with the filings, taxes, or other governmental requirements.
10. **POTENTIAL PLAINTIFFS SUING DIRECTORS** — the potential parties who could bring legal actions against directors include members, creditors, beneficiaries, the Crown, and the organization itself.

## Minimize Risk of Personal Liability

1. **Know the people involved** in the Chamber and on the board. Investigate. You rely on other directors at your own risk. Anyone who accepts an appointment as a "figurehead" director must be aware of that.
2. **Know the constitution and bylaws**, the contract between members. It is the source of authority and responsibility of directors. How is your Chamber incorporated?
3. **Have a working knowledge of what is going on in the Chamber**, as by definition, you as a director are responsible.
  - a. Staff report(s) — make these regular, meaningful, and efficient.
  - b. A new director must visit the operations of the Chamber — observe and make common sense enquiries.
  - c. There must be systems in place regarding employment, contracts, and management of funds.
  - d. Financial statements are required at least annually and usually much more frequently (i.e. monthly). A director must generally understand the financial statements. Try to see the overall picture which the financial statements paint. Be aware of the significant items of assets and liabilities and of income and expense.

**4. The directors should use the Chamber’s auditors.** Many Chambers have a formal audit which involves a Chartered Accounting firm examining the financial records of the Chamber and testing the various procedures and controls. An employee of the Chartered Accounting firm generally attends in the offices of the Chamber for a period of days. The auditor then prepares the financial statements and gives the letter stating his opinion on the fairness of such statements. It is recommended that the auditor attend a board meeting and deliver his financial statements and report in person. The auditor often sees problems that are outside the financial area.

**5. Use your common sense and intuition.** If something feels unsavoury or unsafe, challenge it or investigate it — if you don’t act, who will? You have a duty to understand the overall operation of the Chamber — do not let yourself or the board get bogged down in detail. Do not be afraid to ask fundamental questions regarding the policies and operations of the Chamber and the systems for control.

**6. Liability Insurance for Directors\*\*** is available to indemnify directors against personal liability incurred by their own negligent act or omission or the acts or omissions of employees of the Chamber.

Insurance coverage for directors extends to personal liabilities of directors and officers for wrongful acts and expenses incurred in defending actions. No coverage is available for fines or penalties. A **wrongful act** is defined in the policies as a **breach of duty, neglect, error, misstatement, omission, or any other wrongful act.**

It should be noted that the insurance policies regarding directors’ liability **exclude** the following:

- a. Libel and slander;
- b. Personal gain found to be illegal;
- c. Improper reimbursement;
- d. Breaches of legislation affecting societies to the advantage of the individual;
- e. Failure to maintain insurance on assets of the Chamber; and,
- f. Dishonesty of director or officers

**\*\* The Alberta Chambers of Commerce offers a directors and officers insurance policy through Robinson Insurance Brokers Ltd.**

## On Directors' Liability

### Guidelines to Reduce or Prevent Law Suits

If you are a board volunteer:

1. Attend board and committee meetings regularly.
2. Be familiar with the minutes of board meetings and the minutes of your committee assignments.
3. Be familiar with your Chamber's publications.
4. Treat the affairs of your Chamber as you would your own.
5. Be certain a reputable firm audits your Chamber's records (CA, CMA, CGA).
6. Be familiar with your Chamber's goals, objectives and programs.
7. Insist that all committee meetings are reported at board meetings in written form.
8. Know your Chamber's budget, budget process, and financial situation.
9. Know who is authorized to sign cheques and in what amount.
10. Avoid self-serving policies.
11. Enquire if there is something you do not understand or if something comes to your attention that causes you to question a policy or a practice.
12. Insist that there is a well-established personnel program with a competent administrator.
13. Avoid the substance or appearance of conflict of interest.
14. Be certain your Chamber is fulfilling all aspects of its not-for-profit status.
15. Insist on a written and acted upon board membership and nominating committee procedure.
16. Monitor the community and professional image of your Chamber.
17. Be certain that **policies** are clearly identified and that the board acts on them as a whole rather than by action by a small group of individuals.
18. Know your Chamber: board, financial situation, programs, and staff before you accept membership.
19. Require that your Chamber have proper legal counsel.
20. Monitor the activity of your executive committee to ensure it does not overstep its authority.
21. Insist on the board having a policy relative to board volunteer liability.

## What Directors Cannot Do to Minimize Risk of Personal Liability

- 1. Inaction is no excuse** — even if a director is wilfully blind or careless and has no knowledge of a wrongful act, he/she may be liable even if they did not participate or have any intention of doing wrong.
- 2. Seeing no evil** — a director who acquires knowledge of an illegal act on the part of co-directors, whether by way of reading the minutes of previous meetings or in any other matter, must honour his/her duty to the Chamber and do whatever is necessary under the circumstances to correct the wrong, or bring it to the attention of the members.
- 3. Resigning** — you cannot resign as a director to avoid responsibility during your term served as a director.

## Internal Financial Controls

An effective internal control system is an **absolute must** if your Chamber is serious about protecting itself against employee dishonesty.

The adequacy of the internal control system in use by your Chamber can be gauged quickly by your answers to the following questions:

	YES	NO
1. Does your Chamber require two signatures on every cheque?	_____	_____
2. Does the administrator or that person's designee have the bank statements forwarded to their attention and review the bank statements and cancelled cheques before accounting receives the statements?	_____	_____
3. Are accounting personnel prohibited from being signers on bank accounts?	_____	_____
4. Are cheques received in the mail endorsed by whomever opens the mail before other employees come into contact with cheques?	_____	_____
5. After endorsement, do you prohibit employees other than accounting from coming into contact with original cheques?	_____	_____
6. Are all cheques disbursed either computer protected or imprinted with a cheque protector machine?	_____	_____
7. Does your independent CA, CMA or CGA firm evaluate your system of internal control annually and do you take their		

- suggestions for improvement seriously? \_\_\_\_\_
8. Do you require employees to take vacation? \_\_\_\_\_
  9. Does the administrator or that person's designee control the supply of unused cheques and are these cheques under lock and key? \_\_\_\_\_
  10. Does the stamp you use to endorse cheques received spell out the full name of your Chamber and also include the name of your bank and account number? \_\_\_\_\_
  11. Are two people involved in computing payroll and remitting payroll taxes? \_\_\_\_\_
  12. Does your Chamber have written internal control policies and is deviation from these policies a possible firing offense? \_\_\_\_\_
  13. Do you ever check the bank's records as to authorized signers on signature cards and wire transfer contracts? \_\_\_\_\_
  14. Do you ever do a random check on bank reconciliations and investigate cheques that fail to clear the bank? \_\_\_\_\_
  15. Do you routinely test cash transactions?  
(i.e.: everyone gets a receipt) \_\_\_\_\_
  16. Do you have an effective computer back-up system? \_\_\_\_\_
  17. Do you have a policy whereby credit card applications are *shredded*? \_\_\_\_\_

**IF** your answer to **ANY** of these questions is **NO...**  
Your Chamber may already be the victim of an embezzlement scheme!

**REMEMBER!**

**FACT** — in almost every situation in which fraud have been discovered, the guilty party is almost always the person above suspicion.

**FACT** — it is becoming increasingly difficult to receive employee references from prior employers.

**FACT** — most fraud is detected:

During the course of a CA, CMA or CGA audit	2%
As a result of an internal audit	18%
Whistle-blowers	30%
<b>Sheer accident</b>	<b>50%</b>

When VOIDING cheques — cut off the signature line.

## **When You Find Yourself the Victim**

1. **Investigate first!** Never accuse until you know the facts.
2. Call your attorney and CA, CMA, or CGA for advice.
3. Be careful when confronting the person:
  - Consider having your attorney and CA, CMA or CGA with you, but always have a witness, particularly if the situation is male-female.
  - If there is any possibility of a problem, consider having a police officer with you.
  - It is usually better to confront the person after business hours when fewer employees are present to avoid an incident and embarrassment.
4. On the advice of counsel, the person should be either terminated or put on administrative leave.
5. Make sure you get such items as keys, and credit cards.
6. Consider changing the door locks.
7. Change the computer passwords.
8. Decide whether or not to press charges.
9. Get advice from counsel on how to relate the circumstances to employees and members
10. Get advice from counsel on how to handle references.