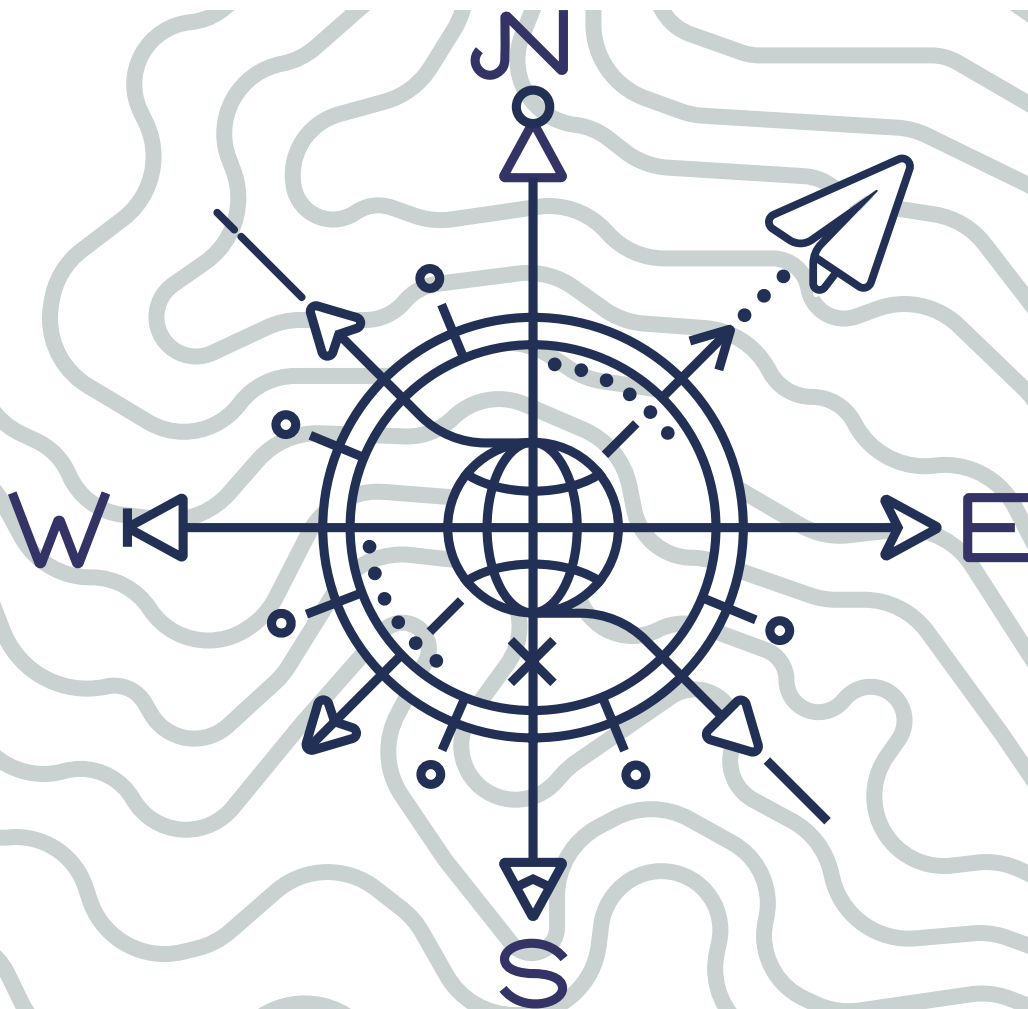


Paths Forward in Financially Troubled Times

**A Restructuring and Insolvency Guidebook for
Charities and Non-profit Organizations**



THE MUTTART FOUNDATION IN COLLABORATION WITH MILLER THOMSON, LLP

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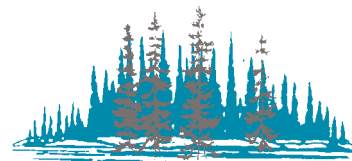
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Disclaimer: This Guidebook does not replace legal advice. This publication can only provide general background on some of the most common matters a board, director or organizational executive may have to deal with. Do not rely on it to make decisions or to take any action. Always check with a lawyer or other expert to get advice on your specific situation.



Table of Contents

Acknowledgements	iii
Preface	1
Introduction	3
Part I: What Path Are You On?	6
Part II: What Types of Creditors Will You Deal With?	17
Part III: What Are Your Options?	21
Part IV: Ceasing Operations Informally	31
Conclusion and Appendices	33



Preface

“We are living in unprecedented times.”

If charities and non-profit organizations received a dollar for every time that truism has been repeated over the last several months, none would be facing any financial concerns at all.

But they aren't getting that dollar. In fact, many are getting very few dollars. And even if finances aren't an issue right now, planning for the “new normal” is occupying the minds of many people.

For some charities and non-profits, the question of “where to from here” is – and should be – a moment for sober reflection. They wonder when they will be able to make their programs and services available again. They wonder when they can stop relying on virtual meetings and meet face-to-face with people. They wonder if they have the money – or the energy – to carry on.

And there are some people thinking the unthinkable: “Maybe we shouldn't carry on.”

For some people, those thoughts are driven by financial realities. Reserves – if they existed – are low, if not totally gone. Some staff members have moved on; finding replacements and training them is an expensive proposition. Trying to pivot all fundraising to a virtual reality is difficult or impossible.

For others, it's a question of energy. Restarting operations is going to be tough. Some people are feeling guilty because they don't seem to have the same degree of passion that they once had. The idea of putting in the time – in delivering service, in governance, in fundraising – just seems like far too much effort.

Let's get some things straight off the top.

First: There is nothing wrong with periodically considering whether your charity or non-profit should continue operating.

Not only is there nothing wrong with it; it's probably a prudent thing to do.

Circumstances change, society changes, people change. Those are all realities. Something that was a pressing need 20 years ago might not be as pressing a need today. New players have emerged to meet various needs, and where your group fits within that ecosystem is a question often worth asking.

Second: Stop beating yourself up. There's no way you could have planned for this.

Unless you are an organization that specializes in disaster-relief, you couldn't have prepared your organization (or yourself) for what we have been facing. Even if you had an emergency plan in place, you could not have predicted that the whole world would effectively be shut down.

You may be feeling guilty because you didn't have enough money in reserve to tide you over. You may be feeling guilty because you've had to lay off staff. You may be feeling guilty because the people you serve are having to deal with things without your help – or as much help as you would like to give.

The reality is that you simply could not have known what we would all be facing.

Third: You are not alone.

Lots of businesses, other charities and non-profit organizations are going through the same thing you are. They are asking themselves if they can afford to resume services. They are asking whether they're ready to resume services, or even want to.

In the U.S. and England, some are forecasting that up to one-third of all charities will not recover. They will close their doors. There is no reason to believe that the situation will be any different in Canada.

Fourth: Planning your future is always better than having the future overtake you.

You have options. And not all of these options are negative.

If you are thinking of closing because of financial difficulties, there are a number of ways you might be able to continue operating through the use of Canada's restructuring and insolvency laws.

Remember: it is not a sign of failure to use these laws. They have been drafted to recognize that businesses, charities and non-profits sometimes face circumstances that are beyond their control. The laws give these companies and organizations a chance to pause, regroup and find their way forward.

If you are thinking of closing because you don't have the human resources or the passion to continue operating, a planned departure gives you the chance to organize things in ways that provide the best possible outcome for your members and for the people your organization serves. There are a number of possibilities, ranging from referring your clients to other organizations to merging with some other charity or non-profit.

The terms used in this Guidebook are "charity" and "non-profit" or "non-profit organization". "Charity" includes both *Income Tax Act (ITA)* registered charities and provincially recognized charities (which may or may not be federally registered). Non-profit or non-profit organization includes federally or provincially incorporated corporations (called societies under some legislation) that are established for a purpose other than profit. As well, sometimes charities or non-profits are trusts or unincorporated associations, in which case the rules that apply to them are slightly different and some options may not apply to them ([See Types of Organizations, p. 4.](#))

The term "Board of Directors" is used to refer to the governing body of organizations, no matter what form that takes or what it is called; similarly, "director" refers to a decision maker on the governing body, no matter what that individual is called.



Introduction

What This Guidebook Will Do

We have put together this Guidebook to help boards and staff of charities and non-profits to understand what options they might have when facing financial adversity. It explores various options that you may want to consider if you are:

- in difficulty, but want to continue operating;
- in difficulty and have concluded that you will shut down your operation permanently; or
- thinking about closing down for lack of funding or other reasons.

Using Canada's restructuring and insolvency laws to give you a fighting chance to survive is not a sign of failure. They are designed to be of help to organizations that, often through no fault of their own, are in precarious positions. They provide an opportunity for a "restart" with a fresh slate.

The material will also give you general legal information about insolvency laws, and how they can apply to charities and non-profits. It will also discuss various aspects of charity law that may come into play whether you decide to continue operations or not.

This Guidebook also discusses steps that can be taken to restore the financial health of your organization without using a formal legal restructuring or insolvency process.

What this workbook cannot do is give you specific legal information about your organization.

Charities and non-profits are very different in terms of size and operations. Some are entirely volunteer-run, others employ thousands of people and have revenues in the hundreds of millions of dollars. The way you are structured, the law under which you are constituted, and your bylaws may all have an impact on the decisions you take.

You may need to obtain professional advice that relates specifically to your organization. In some cases, you may find a professional who will work with you for a reduced fee. In some communities, funders have expressed willingness to help charities that want to find a way to restructure or dissolve in a way that is dignified and the least disruptive to everyone affected.

We appreciate that these are difficult times and that difficult decisions may need to be made for a variety of reasons. Whatever your situation or circumstances, we hope that this Guidebook will serve as a helpful resource that you and your organization can use to guide your way towards a solution.

How to Use This Guidebook

This Guidebook is divided into four parts:

Part I discusses the different approaches and steps charities and non-profit organizations should immediately consider when they recognize they are financially unstable. This

section of the Guidebook will outline what steps these organizations can take where they seek to avoid going through formal restructuring and insolvency proceedings.

Part II discusses tips for dealing with different types of creditors and stakeholders who are impacted by the organization's financial uncertainty.

Part III discusses the different approaches available to financially distressed organizations. This section looks at merging or amalgamating with another organization, steps that can be taken to restructure informally, *Companies Creditors Arrangement Act (CCAA)* or *Bankruptcy and Insolvency Act (BIA)* restructurings, and dissolution or winding up procedures.

Part IV discusses the regulatory and liability considerations of informally closing down an organization.

Keep in mind that in Canada insolvency law is federal. This applies even if your organization is incorporated as a society or corporation under provincial legislation. It also applies no matter the tax status of your organization under the *ITA*.

We hope this Guidebook will help your organization deal with any problems that might arise as it navigates financial difficulties. However, we ask you to keep the following cautions in mind:

- Every organization is different and its problems may be unique. This Guidebook cannot cover all situations;
- The law is complex and there are important exceptions to many rules. There are also many legal issues that are not covered in this Guidebook, and many situations and options that are not discussed; and
- The law is always changing, so some of the information in this Guidebook may be out of date by the time you read it.

Please remember that this Guidebook does not replace legal advice. Do not rely solely on it to make decisions or to take any action. Always consult with a lawyer or other expert to get advice about your specific situation.

Is This Guidebook for You?

Types of Organizations

First things first: your organization must figure out its starting point. This section considers the different organizations that will find this Guidebook useful. It deals with the different ways charities and non-profit organizations are structured.

Unincorporated Associations

If an organization does not incorporate, the organization can carry on operations as an unincorporated association. An unincorporated association is composed of a group of individuals acting in common for a purpose or goal other than profit. Organizations choose not to incorporate for several reasons. Some organizations do not need the legal protection from personal liabilities that a corporation provides. Other organizations have higher priority needs for their limited funding and some wish to be as independent as possible from regulatory oversight.

If you are a member of an unincorporated association using this Guidebook, it is important to remember that unlike a corporation, members of the association, and its decision makers — i.e., individuals who are part of the governing body, whatever form that takes — can be **personally** liable for claims made against the association. That is because it is not a separate legal entity.

Being an unincorporated association may limit some of the legal restructuring options available to you.

Not-for-profit Corporations

A non-share capital corporation (commonly referred to as a not-for-profit corporation or society) is a separate legal entity from its members and directors, formed for a purpose other than generating a profit. While a not-for-profit corporation can earn a surplus, the surplus must be used to meet the goals and purpose of the corporation. Organizations choose to incorporate for several reasons. Some advantages to incorporating include:

- the liability of members and directors is limited;
- the continuity of the organization is assured when the membership changes; and
- the corporation can own property under its legal name.

Trusts

In certain circumstances, charities or non-profit organizations are trusts. Some advantages to establishing an organization using a trust are flexibility, privacy and the minimal cost and time required to set it up.

Unlike non-profit corporations and registered charities, trusts are generally governed by common law, though provinces often codify or modify rules for trusts or trustees through legislation. Trusts are not incorporated and therefore not subject to corporate law rules. The administration of the trust is governed by a written document creating the trust.

Although there are advantages to establishing a trust, trustees can be held personally liable for debts of the trust and actions taken by the trustees. Trustees are obligated to manage the property of the trust as a reasonable prudent person would manage their own affairs. If you are a stakeholder of a trust using this Guidebook, it is important to consider whether there are any provisions in the document creating your trust that limits the liability of trustees, provided they have acted in good faith, as well as provisions that

will indemnify the trustees for some or all debts or liabilities they might incur acting for the trust.

Being a trust may limit some of the legal restructuring options available to you.

Registered Charities

Whether an organization is an unincorporated association, a trust, or a non-share capital corporation (not-for-profit corporation or society), if it is established for a recognized charitable purpose, it may apply to the Canada Revenue Agency (CRA) to become a registered charity. A registered charity must comply with certain rules set out in the federal *Income Tax Act (ITA)* and overseen by the CRA. These rules are important to know if a decision is made to fundamentally change the organization's structure or to wind it up and distribute its assets.



Part I: What Path Are You On?

General Comments

When charities and non-profit organizations face financial hardships, including those caused by the worldwide impact of COVID-19, it is important to understand what options are available to help them navigate through these pressures. This section discusses considerations and practical steps that organizations should consider in times of financial uncertainty.

The timing of these decisions is vital to the ongoing operation of the organization. When an organization enters a state of financial vulnerability, it must act quickly and diligently to formulate a plan. Organizations that fail to plan sufficiently in advance can become overwhelmed with obligations to creditors, landlords, and other stakeholders, and are often forced to rush into decisions that will affect the future of the organization. In the worst-case scenario, this can cause the organization's demise. Both for legal and ethical reasons, you will want to ensure you treat all your stakeholders fairly, and in order to do so, you will want to determine as early as possible where you are headed.

Remember, It's Not All About the Money

In many cases, when a business decides to close permanently, the primary driving force is money. That is to be expected; businesses operate in a world where revenues and expenses — i.e., profits — are the defining factor in determining success.

Things are different with charities and non-profits. Your organization was established to deliver some kind of public or stakeholder benefit. You have people who have come to rely on you and the services that you provide.

Your organization also likely has members. They have joined your organization, sometimes for the services they receive, but often because they believe in what you do, and want to help – with their time, with their funds, and with their talents. They have a stake in what you do.

Considering whether to make a go of it, or to close your doors, is one of the most important – and difficult – decisions your organization will make. The role of directors, staff, and members in approving and carrying out a shutdown varies between organizations. Generally, all will play some part. How and where decisions related to a shutdown are taken depends on what legislation the group operates under and what the organization's bylaws require. What to communicate and to whom, will be important steps along the way.

Clearly, your organization's board of directors will need to know all the facts and the sooner, the better. They will have to make decisions about what options to explore. Members of your board, and even members or other volunteers in your organization, may have experience or contacts that could be helpful to you.

Your board or staff may be able to find help from other charities or non-profits. They may have expertise or information that could be helpful to

you. They might be able to suggest ways in which your two organizations can work together.

As you consider what your future will be, remember the values that underlie your organization. You were established to provide a benefit to some group of people. Even if you are leaving the field, you can still try to ensure that the individuals or group you serve continue to have access to needed services. If you're going to continue, so much the better. Many of your stakeholders will understand if there must be changes and will be prepared to tolerate bumps in the road as you make your way to your new normal.

Depending on how your organization is structured, and what actions you decide to take, you may need to have a meeting (likely virtual until the COVID-19 pandemic subsides) of your members. You may also want to involve other stakeholders by inviting them to a member meeting or through other outreach. News of a possible closure will be difficult for some of them to take. The more information you can give to them, and the more you give them a chance to grieve the loss of the organization, the better. They may be able to offer suggestions. At the very least, they will appreciate being informed of the plight you are all facing together.

Knowing Your Organization is in Trouble

For many charities and non-profit organizations, their revenue and expenditure mix will be quite different from their for-profit counterparts. For our purposes, charity and non-profit organization sources of revenue can be divided into three categories: (i) government grants and contracts; (ii) earned income from sales of goods or services; and (iii) fundraising.

On the expense side, like for-profits, a charity or non-profit organization will have suppliers. They will also likely have mortgage or rent payments. However, because of the nature of

the products and services it offers, a charity or non-profit organization may have significant future obligations to customers, members or beneficiaries. This sometimes happens with for-profits as well, but it is not the norm.

Professional accountants have devised ways to deal with the financial differences between for-profit companies and charities and non-profit organizations. They also have ways to provide for timing considerations with income and expenses. If the charity or non-profit organization has a public accountant do an annual audit or review engagement of its books and financial statements, those statements will show the current situation, but also indicate timing issues for future funding or obligations.

Owing to the unique nature of the operations of many charities and non-profit organizations, standard ratios used to assess financial statements should be used with caution.

Where an organization does not engage a public accountant, the fine points of the organization's financial position may be hidden or less well understood by the group's management and board. But making the effort to understand is crucial. Regardless of the circumstances, producing and reviewing regular statements of cash flow are essential to understanding the financial health of an organization. A cash flow statement projects future income and expenses for a period of time to help ensure an organization does not fall short of resources at any point, even if its balance sheet indicates that it is solvent.

Although no one can predict the future, here are some observations with respect to the three revenue streams for charities and non-profit organizations identified above:

Government Grants and Contracts

Governments have long relied on charities and non-profit organizations to deliver frontline services, typically at lower cost and more dynamically than if those same services were

delivered by government itself. Research indicates that much of this work is not fully funded. Funding shortfalls can take the form of not paying for infrastructure expenses, not fully covering the benefit costs associated with funded positions, and not providing for enough staffing to meet an identified need. This model is based on the supposed ability of charities and non-profit organizations to use donated monies and or volunteer resources to cover any funding gaps.

With the weaker fiscal position of governments in the coming years, stemming from the massive spending to address the COVID-19 crisis, it should be anticipated that governments will have fewer resources to fund services through charities and non-profit organizations. Where it continues to fund, government will likely do so even more frugally than it has in the past. As well as recognizing this, organizations will have to take into account potentially diminishing earned income and fundraising revenues. This will make it harder than ever to cross-subsidize or supplement the shortfalls that are often seen in government funding arrangements.

Earned Income

In the early months of the pandemic, reductions in earned income varied widely across organizations. A drop of 50% was not unusual, with many organizations reporting an even sharper downturn. It is widely believed that the COVID-19 crisis will accelerate the changes in the retail environment that were already underway in recent years. This may present opportunities for some organizations, particularly those with a strong digital profile and with good branding. However, sales that involve face-to-face interaction or enlist volunteers will likely take an extended period to recover, if they ever do.

Organizations that rely on conferences or similar live functions as an income stream may be able to substitute virtual events. However, these are generally less lucrative than their traditional counterparts. It is unclear what, if anything, will arise as a substitute for the networking

opportunities that many of these events provide. It is reasonable to assume that the online marketplace for these types of functions will become more crowded over time.

As of late 2020, it is not clear for how long physical distancing requirements will need to be maintained. Until distancing rules and other measures are relaxed for many organizations their earned income revenue streams are likely to remain highly uncertain. As well, owing to the economic impact of the pandemic, clients or supporters may have fewer resources for discretionary spending. So, a return to past norms for earned income should not be assumed unless there is high confidence that can be achieved given the circumstances of the organization.









Fundraising

Fundraising revenue changes during the pandemic also varied by organization, but a large percentage of charities and non-profits saw a steep decline during the initial economic shutdown. Some of this was offset by government emergency funding and early donor enthusiasm for causes linked to COVID-19 work or economic relief. The cancellation of essentially all in-person fundraising events and activities left a large hole in the budgets of many charities and non-profit organizations. While there was an uptick in online fundraising, it remains to be seen how sustainable this will be.

In the aftermath of the pandemic, the tighter financial situation faced by many Canadians stemming from the downturn in the broader economy may affect their ability to make donations — possibly for years into the future. As with earned income, it is likely prudent to assume past fundraising performance may not be repeated in the short term.

Once you determine that your organization may not be financially sustainable, there are several approaches that you can consider. They are summarized in the chart below.

PATHS AT A GLANCE

Merger / Amalgamation		<ul style="list-style-type: none"> • Considerations: Finding the right strategic partner • Outcome: Newly formed, consolidated organization
Shared Services Arrangements		<ul style="list-style-type: none"> • Considerations: Scope of collaboration • Outcome: Cost reduction and increased efficiency
Restructuring		
1. <i>Informal</i>		<ul style="list-style-type: none"> • Considerations: No legal protections; flexibility • Outcome: Organization continues if creditors agree not to enforce
2. <i>Companies' Creditors Arrangement Act (CCAA)</i>		<ul style="list-style-type: none"> • Considerations: \$5M or more debt threshold • Outcome: Organization continues if creditors and court approve plan of compromise or arrangement
3. <i>Bankruptcy Insolvency Act (BIA)</i>		<ul style="list-style-type: none"> • Considerations: Ability to forestall creditors and reduce debt load • Outcome: Organization continues if creditors and court approve proposal
Voluntary Assignment into Bankruptcy		<ul style="list-style-type: none"> • Considerations: Must have debts in excess of \$1,000; all assets vest in trustee • Outcome: Disposal of assets by trustee and creditors may recover portion of debt
Winding Up / Dissolution		<ul style="list-style-type: none"> • Considerations: Ordinary closure of organization; decisions made by stakeholders • Outcome: Organization and goodwill lost
Ceasing Operations Informally		<ul style="list-style-type: none"> • Considerations: Potential remaining liabilities and obligations • Outcome: Organization lost and possible reputational damage

Forward Thinking

Once the organization has taken stock of things, the governing body of the charity or non-profit organization (typically the Board of Directors) must act in the best interests of the organization. This may mean weighing trade-offs. Should the organization cut back in the short term and reserve resources for the future? Or should it focus on meeting immediate commitments, even if this puts longer term activity at risk? In many circumstances, this will be a judgment call, with no right or wrong answer.

These are hard and often unpleasant choices, so many organizations delay making them. With early assessment of the situation and consideration of what's possible, your organization will be able to make better choices and will likely increase its chances of weathering the storm. Committing fully and quickly to a new course is frequently the only way to get "ahead of the curve". Moving in a particular direction will inevitably mean some other choices are closed to you, but this is less often a problem than having options no longer available because you didn't move fast enough. Beware of being indecisive.

For example, streamlining operations by transferring programs or scaling back by selling assets may be hard steps to take. The current widespread economic uncertainty makes things even more difficult, so the timing for this type of restructuring may not be ideal. Mounting the effort needed to locate opportunities to offload resources or programs to other groups while coping with the pandemic will likely also be a challenge. Still, quick action may mean the difference between surviving and not. Research and evaluate possible courses of action as well as you can, then determine how to proceed. Decisions will be assessed on whether you reasonably believed they were in the best interests of the organization, not on whether they were perfect.

One avenue to explore as part of efforts to trim costs or improve efficiency is shared services. This

involves collaboration with another organization or organizations to consolidate some of your administrative or back office services. Among the tasks sometimes shared by groups are human resources services, financial and bookkeeping functions and information technology management. But collaborations occur in a host of other areas as well. Arrangements may be limited to one part of your operations or be quite comprehensive. The scope and details of each arrangement will vary based on organizational needs and preferences, and the ability to find willing partners. ([See Shared Services Arrangements, p. 22.](#))

Always keep in mind that decisions the organization makes must be in line with the group's mandate and any requirements in the organization's governing documents. If these decisions involve legal restrictions on assets or need to be confirmed by members, the organization must obtain the required approvals prior to acting.

Consider your Current Financial Situation

The first step organizations must take when planning during a period of financial uncertainty is to review their current financial situation. This allows the organization's decision makers to identify the urgency for change and the timeline needed to develop and implement a plan of action.

Organizations should focus on cash flow management by identifying payments and obligations that need to be made over different timeframes. To fully capture the current financial situation of the organization, decision makers should focus on required payments in weekly and monthly increments. The organization should also consider whether it has cash available to cover short term financial obligations as they become due. Finally, the organization should determine how much income is realistically expected over the time periods being examined. This forecast

provides the organization with a forward-looking view that will enable it to plan ahead and identify whether it is or will be at risk of running out of cash.

This analysis will help the organization pinpoint if, and when, a shortfall is expected. This will help the organization assess how it should operate in the short-term and recover in the long-term. If this process reveals that the organization is not going to be able to continue some or all of its operations, a plan will be needed — likely including obtaining outside advice — for restructuring, reorganizing or, in a worst case scenario, winding up its operations.

Options for Minimizing Costs and Increasing Income

Having the necessary amount of cash flow to continue operating is vital for survival. Maximizing income streams and minimizing immediate and ongoing expenses (which likely mean difficult decisions and hard choices) will allow the organization to maintain the required amount of cash flow in times of financial uncertainty.

An organization can minimize its costs through a variety of mechanisms. First, organizations may need to identify and shut down any non-essential programs or curtail discretionary expenditures. This allows the organization to focus solely on matters central to ongoing operations. Organizations should seek and, where possible, move to lower cost methods of operating. It may want to assign an individual or team with specific responsibility for doing so. In some situations, technical efficiencies may be possible. In other cases, it may be possible to negotiate better pricing or discounts with suppliers, service providers or lenders. Remember that with hardship being felt across the economy, at least some of the institutions, firms and people you deal with may value maintaining relationships rather than seek to maximize their return on transactions.

Alternatively, organizations can identify and team up with other charities or non-profits with similar goals to share resources. This will be discussed in more detail below.

It might also be financially beneficial for an organization to reduce the scope of the organization's services or suspend part of the organization's work temporarily. This might involve cancelling certain events or contracts, or even closing down some part(s) of the organization. Regardless of the way the organization has decided to minimize costs, look into federal, provincial and municipal government schemes available to reduce, spread out, or delay payments.

When it comes to preserving or increasing income, organizations should consider the following:

- Engage in early dialogue with funders, letting them know the financial situation of the organization and its plans to overcome any challenges. Many funders are facing significant calls on their resources in the wake of the pandemic, and advising them of your situation will help them in setting their priorities and determining which organizations or initiatives they can assist. Consider whether the organization is able to raise emergency funds in innovative ways.
- Consider whether grants or low-interest (or interest-free) loans are available.
- Explore whether there is a way for the organization to get designated funds (money that is allocated to a specific purpose) for general use.
- Explore tapping into reserve funds, if they are available. This should include determining if these funds can be used and what the risks of accessing them are. If these funds are accessed in the short-term, the organization may have to postpone or cancel longer term uses originally planned for the reserves.

Accessing Restricted Funds

It is not uncommon for organizations to have funds that have been received under a gift agreement, will or contract which are restricted to a particular purpose or use. This is particularly the case for registered charities but is not unusual for non-profit organizations. For example, a charity or non-profit might have received funding from a donor that is designated solely for specific use. When such organizations are strapped for cash, an alternative for the organization is to explore accessing these funds that have been restricted for a specific use.

The question that must be carefully considered by the organization with restricted funds is whether they can be accessed. This would require consideration of the agreements under which the funds were received and also, in the case of charitable entities, consideration of whether the restriction was placed on the funds by an external party or internally as part of a strategic or business plan. For registered charities, funds that are formally restricted for a specific purpose by external donors can generally not be accessed and applied to another purpose without a court order. Therefore, organizations must be very careful when considering what funds are available for use.

The first step that should be taken by any organization when considering the use of restricted funds is to question how the restriction came about. If the funds are provided pursuant to a grant agreement with government or another party, reference should be made to the documentation to determine if it says anything about changing the restriction or using the funds for other purposes. If the funds were restricted by the Board of Directors or for business planning purposes by the organization itself, that restriction can likely be changed and the funds used. If, however, the restriction was placed on the funds at the time of a gift by an external party and there is no written documentation that speaks to a change in use, the law that is

applicable to all charities in Canada requires that the restriction cannot be changed without an application to a court arguing that the purpose for which the funds was gifted is no longer achievable and asking for an alternative use to be approved.

This can be a cumbersome process but the law places a high priority on following the wishes of the donor. It is also not certain that the court application would be successful. The difficulty is that generally the only time courts will consent to this is when the organization can demonstrate that achieving the restriction is no longer viable. It is unclear, based on case law, that financial difficulties would be a sufficient reason to obtain court consent.

Ontario is the one province that has a slightly more helpful process. The Office of the Public Guardian & Trustee (OPGT) takes an interest in these issues and it is possible to work with the OPGT and obtain consent and an over-the counter court order to alter the restriction. Thus, the court application might be avoided. Further, and in response to COVID-19, the law is slightly different. Under Ontario's legislation and in light of the economic uncertainty, the OPGT has developed temporary guidelines to allow charities that are experiencing a state of financial uncertainty to access capital with a restricted purpose when it is necessary to enable them to continue their day-to-day operations.

These guidelines state that charities in Ontario may access and use funds subject to the following conditions:

- The organization must be in danger of closing (including becoming insolvent or filing for bankruptcy);
- The organization must explore all other options before using restricted funding;
- The organization must notify the OPGT;
- There must be a unanimous approval from the Board of Directors for accessing restricted funding;
- Restricted funding must be used solely

for operating expenses and contractual obligations of the organization. This funding can only be used to the extent it becomes necessary to remain solvent and operational; and

- The organization must keep an accounting of these used funds, and the amounts used must be reasonable given the circumstances of the organization.

At the time of writing there are no similar guidelines in other provinces, but Boards of Directors of charities outside Ontario may wish to use these guidelines as a benchmark when considering an application to the court asking for consent to access restricted funds. Note, however, that these court proceedings may be costly and that financial uncertainty may or may not be accepted as a good reason to access the funds. Given the novelty of the current situation, there is no way to gauge the openness of courts outside Ontario to such requests.

As indicated above, every organization, registered charity or otherwise, needs to turn its mind to whether in their particular circumstances the funds can be accessed. In doing so, it must review whatever documentation exists to support the restricted use and consider whether a change to that use can be legally made.

The rules that apply to common-law charities which are discussed above could, in fact, apply to trust funds held by non-charities where the purpose for which the fund is established would be considered charitable. As well, grant agreements from funders – private or government – often contain provisions which limit the use of the funds provided for a particular project and accessing those funds can result in defaults and penalties. Care must be taken before such funds are tapped but accessing these funds – provided any needed authorization can be obtained – is worth considering for any organization that is grappling with financial uncertainty.

Keep the Organization's Operations and Finances Under Regular Review

Frequent and robust monitoring of the organization's finances is critical for the effective management of resources and will help in deciding if the organization can continue its charitable or non-profit activities. It is good practice for organizations to do on-going cash flow analysis even when they do not face financial hardship.

Tips for Managing Revenues and Expenses during a Crisis

The following are some practices and strategies that can be implemented by charities and non-profits in response to a downturn in the economy or other financial distress. These measures can be used both for COVID-19 and for other emergencies.

1. *Ensure financing remains viable*

It is best not to assume that the financing mechanisms that the organization previously used will continue to be available in the future. Groups have been impacted differently by economic downturns. Organizations should consider how much cash they will need moving forward and examine alternative financing tools, such as lines of credit.

2. *Consider the organization's discretionary costs*

By focusing on reducing their discretionary (sometimes referred to as "variable") costs, charities and non-profits can improve their bottom line gradually during periods of financial uncertainty. As a large portion of any charity's or non-profit's discretionary costs are typically for staff, cutting these costs may entail temporary lay-offs or permanent reductions in staff.

3. *Focus exclusively on work furthering the organization's core purpose*

Concentrate on the "must dos" rather than the "could dos". Focusing on projects that advance

the core purpose of the organization is a way groups frequently opt to reduce unnecessary costs during prolonged financial uncertainty. Resources should be devoted to meeting basic needs, with secondary initiatives and small one-off projects set aside for later.

Cash flow monitoring should be an integral component of an organization's overall risk assessment and action planning. Planning and acting early, even if the organization has not yet been impacted, could be the difference between your organization filing for bankruptcy and surviving a period of financial uncertainty.

Other Key Areas for Organizations to Focus on During the COVID-19 Pandemic

Organizations should continuously analyze the current and anticipated future impact on them of financial uncertainty due to COVID-19. What this means will be determined by the nature of your operations. It will likely include looking at the impact on others with similar mandates to you, your clients, your suppliers, stakeholders, and other strategic partners. In order to react to changing circumstances, your analysis should be updated regularly.

Additionally, non-profits and charities should be updating their existing business plans to address the anticipated impact of COVID-19. On top of managing the day-to-day operations, which is difficult during these times, this may put a strain on resources. Regardless, strategic planning is critical. Among areas where organizations may consider changes are: the way the organization is marketed, alternative revenue streams, project priorities, and, impacts on employees and the work environment.

Strategic planning should address both: (i) developing a plan for operating during COVID-19, and (ii) how to operate as the world moves out of the pandemic.

1. Forbearance of covenant breaches

Some steps that could be considered as part of the planning process, and implemented or negotiated if they are seen as viable, include forbearance of covenant breaches (the technical term for not being made to comply with certain things stated or promised as part of loans or other agreements).

Some grants or government funding may be subject to a contractual clause restricting the organization from using funds for any project other than that for which the contribution or resources were intended. Given the period of financial uncertainty, organizations may seek exemptions from these clauses to be able to use the funding for day-to-day operations and focusing on the charity's core objectives.

2. Deferral of interest and/or principal payments

If the organization has taken out a loan, the organization can potentially approach the creditor and ask for a deferral of interest or principal payments, interest rate reduction or, if possible, payment forgiveness so that it can allocate its resources to staying solvent.

3. Approach investors and creditors with a well-thought-out plan

Stakeholders and creditors are apt to react much more positively to a concise, thought-out and detailed presentation on the current state of an organization than to being surprised by sudden major changes. In letting individuals and companies you deal with know where things stand, information should be provided in the context of the group's operations, as well as discussing the organization itself. So, as well as a summary of how COVID-19 has impacted the organization, communications should look at the consequences for similar groups, donors, and beneficiaries or clients.

Depending on how much information you want to share, material can also include assessments of what future impacts are likely, the options available to the organization for increasing cash flow and reducing costs, and weekly, monthly and long-term forecasting. By showing your stakeholders and creditors that the organization is proactively considering and planning for financial uncertainty, they may be more open to assisting in any way they can. If possible, the organization may want to involve a financial consultant or accountant to assist in developing a plan.

Director and Officer Liability

Directors of registered charities and non-profit corporations in Canada are required to act in the best interests of the organization. When a corporation is going through a period of financial uncertainty, a formal restructuring, or winding up, it is important for directors to operate with a heightened awareness of their fiduciary duties. They should also understand that they can be held personally liable for decisions that harm the interests of different third parties.

Directors may be exposed to monetary claims, either through legal actions or under regulatory provisions if they do not act prudently while carrying out their obligations in the interests of the organization. This is a tricky balancing act but one which can be done with proper diligence, care and with obtaining the needed advice when things are very serious.

In Canada, directors of corporations have a statutory or common-law duty to act honestly, in good faith and for the best interests of the corporation. They must exercise their duties with a reasonable degree of skill, diligence, and care. The courts have also confirmed that directors of corporations have a heightened duty of trust in certain circumstances. This heightened duty requires directors, for instance, to take proactive steps to protect an organization's charitable trust assets. Any loss resulting from a director's failure to act with respect to charitable property can result in personal liability.

Directors are also responsible to ensure charitable trust assets are invested in accordance with the "prudent investor" standard. This standard, and often mandatory investment criteria or procedures, are typically set out in provincial trust legislation. Liability does not arise from poor investments provided that due diligence is taken when making decisions. It can arise from bad or grossly negligent decision making and can also arise from overly conservative investment decisions that result in missed opportunities.

More generally, when their trust obligations apply, the question that these directors must ask themselves is, "what would a reasonable and prudent person managing his or her own affairs do in this situation?"

Directors of charitable or non-profit organizations also have special obligations where a director fails to apply funds with special purposes in accordance with restrictions imposed by a donor ([See Accessing Restricted Funds, p. 12.](#)) When funds are redirected for a purpose different from one for which they were initially given, the director can be found responsible and be asked to replenish the assets in the charity.

The *Income Tax Act (ITA)* imposes potential personal liabilities on the directors of any corporation. The *ITA* states that directors remain liable for employee income tax source deductions that the corporation fails to remit for two years after ceasing to be a director. Similar obligations arise under the federal *Excise Tax Act* for Harmonized Sales Tax/Goods and Services Tax (HST/GST) remittances. To avoid triggering these provisions, directors need to be proactive and implement measures to ensure that income tax deductions and HST/GST payments are being remitted regularly. Organizations should establish payroll trust accounts and require the executive team to provide the board of directors with frequent reports on remittances verifying compliance. ([A sample Compliance Certificate, which is a tool for boards to track the status of remittances can be found in Appendix A, p 34.](#))

Additionally, directors of registered charities can be liable if the charity fails to comply with reporting requirements under the *ITA*, which includes filing the T3010, the annual charity information return. Not-for-profit corporate legislation may also provide for personal penalties against directors if an organization doesn't make its corporate filings or does so late.

When a corporation is financially stable, the director's duty to the corporation often overlaps with the interests of creditors and donors. However, when an organization is going through a period of financial uncertainty, or initiates insolvency proceedings, the director's duty to the corporation may diverge from the desires of creditors and donors. In these circumstances, directors must assess the impact that a particular decision will have on the corporation's creditors or donors, including whether it could reasonably be expected to impact the corporation's ability to satisfy its obligations. These decisions are important because creditors and donors may be able to, in some instances, bring an action personally against a director under corporate legislation. That said, it is well-established law that the charitable purpose of the corporation is a director's foremost concern.

The risk of personal liability to directors of registered charities and non-profit corporations can be mitigated in the following ways:

- Implement and adhere to appropriate corporate governance policies and procedures before issues present themselves;
- Ensure decisions are made by directors that have no interest in the outcome and potential conflicts of interest are dealt with. (This includes that directors don't have a personal stake in the matter and don't have any family, business or organizational affiliations that could taint their deliberation or vote. If any of these factors apply, the director should withdraw from the decision-making process);
- Utilize legal, financial and other professional advisors to provide informed advice on issues relevant to a decision; and
- Plan for uncertainties, such as the potential need to obtain protection from creditors under the *CCAA* and/or *BIA*.

Other measures that can be taken to protect directors include obtaining Directors and Officers liability insurance and providing indemnification for directors in bylaws.

Note that most Directors and Officers insurance policies are claims-made, rather than occurrence-based. (Occurrence-based coverage applies to conduct or events during the term of the policy; claims-made depends on the timing of the claim and does not apply if that is outside the policy period.) Some Directors and Officers insurance policies cover statutory liabilities triggered by bankruptcy or dissolution. Care should be taken to ensure the scope of coverage is appropriate for the circumstances.



Part II:

What Types of Creditors Will You Deal With?

When charities and non-profits are in the process of restructuring their affairs, they deal with a variety of stakeholders and creditors. Below are the specific creditors and stakeholders that are common to charities and non-profits.

Always remember that if you eventually take legal steps to restructure or wind up your organization, there are laws about what can and can't be done in transactions with creditors and stakeholders in the period immediately prior to the legal restructuring or wind up.

Banks

Charities and non-profits often deal with banks and other financial institutions when they need external capital and take out loans. When the bank makes a demand for a repayment of its loan, it is important for organizations to plan to minimize exposure on guarantees and government trust claims. Below is a list of questions that should be considered.

1. *The demand*

Organizations should begin by considering what information is contained in the demand. Has the bank delivered a **“notice of intent to enforce security”** under the *Bankruptcy and Insolvency Act*? If so, the bank can enforce its security after only 10 days. In such a case, the organization should seek legal advice in order to assess its legal options.

The organization should also note whether the bank has delivered a **“notice of sale”** under provincial personal property security legislation, if the loan was secured. If it has, the bank may appoint a receiver to sell off the secured assets after 30 days. Thoroughly reviewing and considering the demand made by the bank will help the organization formulate a plan in the short-term.

2. *Loan and security documents*

Organizations also need to consider the terms of their loan agreements and whether they were secured (had property pledged to back the loan). Rather than waiting until the bank makes a demand, proactively tracking when loan payments are due and when the term of the loan expires will allow charities and non-profits to plan ahead and anticipate when they will not be able to make required payments. Organizations should also consider what constitutes a default under the loan and whether there are any personal or corporate guarantees associated with the loan.

3. *Negotiating with the bank*

If there is good will between the organization and the bank, the bank might agree to delay acting to seize or sell property pledged to back the loan, provided the organization enters into a “Forbearance” agreement on the bank’s terms. Forbearance agreements might be appropriate if the organization needs time to organize its affairs in order to get back on track with the bank or to refinance its loan. The terms of a forbearance

agreement will generally be more onerous than the original loan terms, with detailed payments, increased interest and possibly additional security.

Landlords

Another creditor that charities and non-profits often deal with is a landlord. When a commercial tenant is in financial difficulty, there are often several creditors seeking to recover debts owed to them. Throughout the period of financial uncertainty created by the spread of COVID-19, charities and non-profits might require assistance from their landlords. This assistance can come in many forms, and organizations are encouraged to explore all alternatives when it comes to negotiating with their landlords.

Seek rent reduction or abatement agreement

Rent reduction or abatements are agreements between a landlord and tenant to reduce the rent owed to the landlord for a specified period. Rent reduction and abatement agreements allow landlords to cover their property tax and operating expenses during periods of financial uncertainty. Rent reduction or abatement agreements should always be in writing. While the details of such agreements can vary depending on the unique interests of the landlords and tenants, charities and non-profits should consider including the following:

1. Term

A rent abatement agreement should always include a term period. Based on its forecasting, the organization should seek an end date to the agreement when it expects to be more financially stable. If no formal end date is determined by the parties, the landlord will have the opportunity to increase rent back to the initial amount after delivery of reasonable notice to the tenant.

2. Is rent abated or deferred?

A rent abatement is an agreement between the landlord and the tenant that provides a period

of free or reduced rent. During the abatement period, the tenant is either not responsible to pay rent at all, or only responsible for the agreed-on reduced amount. A rent deferral refers to an agreement between a landlord and tenant whereby the parties agree to defer the rent owed to the landlord to a later date. This distinction is important to note and organizations should negotiate with their landlords based on the specific need of their charity or non-profit.

3. Will the landlord preserve all its current default remedies under the lease?

If the organization fails to pay the reduced/abated minimum rent, the landlord will likely insist that it is entitled to exercise any of its current rights and remedies under the previously agreed-on lease. This should also be specified in the rent abatement/reduction agreement signed by both the landlord and the organization.

Try to negotiate a surrender of the lease

If the organization has determined that it cannot continue to operate under the terms of its current lease, and it has exhausted the options outlined above, it can attempt to negotiate a surrender of the lease. A surrender by a tenant of its lease leads to ending of the landlord-tenant relationship on the landlord's acceptance. In order for a surrender of lease to have force, it must be agreed on by both the landlord and tenant. Once the landlord accepts the surrender, the landlord will only be entitled to claim any back rent owing up to the date the surrender was accepted.

In negotiating the terms of surrender, charities and non-profits should consider the following:

- The effective date of the surrender;
- The amount remaining payable by the organization up to the date of the surrender;
- The date the organization is expected to vacate the premises and in what condition the premises are required to be delivered; and
- Is it possible to negotiate a legal release, in which the landlord agrees not to claim anything further from the organization?

Statutory Creditors

In addition to landlords and financial institutions, charities and non-profit organizations will need to consider “Crown creditors” such as Canada Revenue Agency (CRA) or provincial tax authorities.

Canada Revenue Agency — Deemed Trust Claims

The CRA has a number of powers at its disposal to collect tax amounts owed from corporations with unpaid assessments. When source deductions and HST/GST withholdings are not remitted when collected, a “deemed trust” – a form of enhanced security – is immediately triggered, which establishes a claim on all of the taxed corporation’s real property and personal assets. Deemed trust claims are in effect “super priority” claims that rank ahead of all other creditor claims. Although certain security interests are exempt from the super priority for source deductions and HST/GST arrears, these exemptions are narrow.

In addition to HST/GST, employers are also deemed to hold amounts deducted from employees’ wages for Employment Insurance (EI) and Canada Pension Plan (CPP) contributions in trust. If an organization does not remit these statutory remittances, the CRA can assess the organization and require payment in full for the amount owing.

As such, it is crucial for the board of directors to ensure that the organization remains current with respect to statutory remittances. Where groups fall behind on these payments, the CRA will be able to take enforcement steps, not only against the corporation with priority over other secured creditors, **but also against the directors personally** ([See Director and Officer Liability, p. 15-16.](#))

Other Types of Creditors

There are, broadly, two types of creditors: “secured” (those with a claim on property pledged against amounts owed) and “unsecured” (those without a claim on property pledged against amounts owed). Most modest-sized charitable or non-profit organizations, however, do not have secured creditors. A more common type of obligation for these groups are prepaid membership subscriptions. For some groups, who receive payments in exchange for memberships to the organization, their biggest “creditors” may actually be their members.

This important distinction is highly relevant to charities and non-profits with membership-based business models. Where an organization employs a membership model, individual claims by members for the return of membership fees may not be cost-effective or practical for individual subscribers, or “creditors” to pursue against a charity or non-profit. So a restructuring proposal or, alternatively, a bankruptcy may be an efficient mechanism to resolve membership claims. Whether this is the case will depend on the membership model of the organization, including the size of fees and the size of membership.

In dealing with unsecured creditors and stakeholders, such as members, it is important to communicate with them on a personal level and explain to them the legal or other steps the organization is taking and why.

Organization Staff

Charities and non-profits going through financial uncertainty need to carefully manage and support their employees. If it has been determined that lay-offs are the most appropriate financial response for the organization, they should be carried out quickly and communicated clearly. Organizations will want to state the reasons behind and details of the layoffs, not only to those directly impacted, but to the organization as a whole.

With respect to employees still with the organization, management should be considering how best to maintain morale and get the most out of remaining staff. This may include having regular follow-ups with employees, watching out for signs that they might be overwhelmed or struggling, providing any needed technical or logistical support, and keeping an eye on mental health.

Communicating with all Stakeholders/Creditors

Although tips and strategies for dealing with different types of creditors and stakeholders have been described above, when communicating with anyone, it is important to keep the following three factors in mind:

- 1. Focus on transparency.** No matter who the stakeholder is, it is helpful for charities and non-profits to be open and honest with their stakeholders regarding how the organization is responding to the financial uncertainty. That said, the organization should be mindful that full disclosure of the organization's financial situation may harm the organization's efforts to restructure and trigger creditor enforcement. To reach the right balance, the organization would be well served in seeking out legal or other professional advice to develop a well-thought out communication plan.
- 2. Focus on the relationship.** This relates to empathetically caring for the organization's customers, donors, and other strategic partners. This also involves pointing out resources where they can get help.
- 3. Focus on being accurate and factual.** Organizations should make sure to connect their stakeholders with accurate information and factual resources to help support them through COVID-19.



Part III: What Are Your Options?

● Merge/Amalgamation

Financial uncertainty has caused many charities and non-profits across Canada to consider organizational changes to remain solvent. One of the options available to your organization involves merging (sometimes called amalgamating) or collaborating with other charities or non-profits.

Why should your organization consider a merger?

For charities and non-profit organizations, mergers can happen:

- When an organization faces financial uncertainty, either for external reasons, such as the pandemic, or for internal reasons, such as a revenue shortage stemming from an income source underperforming;
- When an organization sees opportunities for cost savings and/or economies of scale if it joins with another group; and
- When an organization sees opportunities for synergy or complementary work with the purposes and activities of another group.

Pre-merger steps

Before the organizations involved decide to merge, there are several issues that need to be analyzed. Some questions to consider are listed below:

- What is the purpose behind considering a merger? In cases of financial uncertainty, among the key drivers of the merger will be

to collaborate and share resources.

- Have the necessary professional advisors, including legal counsel and accountants, been retained to assist and provide advice on the prospective merger?
- Who are the stakeholders of each organization and how will their interests be impacted by the proposed merger?
- Has consideration been given to how the organizational cultures of the two groups will be integrated and blended?
- What is the plan in place for carrying out the merger?

The following steps should be taken for one organization to successfully merge with another:

- Obtain preliminary approval for merger discussions from the Board of Directors;
- Have a prospective merger partner execute a confidentiality and non-solicitation agreement;
- Determine what legal steps are necessary for the merger to happen;
- Establish a process to deal with the merger;
- Identify all the assets owned by each organization, restrictions on assets and how those assets can be transferred from one organization to the other;
- Identify all the liabilities and other obligations of each organization. This might include active contracts, leases, employment agreements, partner agreements etc.;
- Undertake an in-depth due diligence process on the potential partner; and

- Obtain any needed organization and regulatory approvals.

Post-merger

Following a merger, operations should be reviewed to ensure work is being done in an efficient and effective manner. Synergies between organizations may take time to develop. It is important to work together to meet the immediate day-to-day needs of the new organization.

[\(See Appendix B for resources on mergers and amalgamations, p. 35.\)](#)

Shared Services Arrangements

Many charities and non-profits are not big enough to efficiently provide all their own support functions internally, or do not have the volume of work to justify major commitments of staff or resources to administrative aspects of the group's operations. One response to this is to contract out certain parts of the organization's operations. Another is to have some staff working only part time or occasionally.

Where the organization is financially healthy, the hidden costs, drain on management time and fluctuation in capacity that are often a feature of these solutions may not be a major concern. These are somewhat offset by being able to do things entirely your own way.

A group in financial hardship, however, may find that a shared services model is a better option. Shared services are where organizations collaborate to create the capacity to meet their needs in one or more support functions. These arrangements can be limited to a pair of organizations or can involve multiple groups. They can range from co-occupancy of premises to co-operating on specific functions such as human resources, financial management and bookkeeping or information technology to having a joint back office carrying out numerous administrative and technical tasks.

One of the major challenges of shared services models is identifying a suitable partner or partners for a collaboration. However, with the widespread financial impact of the pandemic, anecdotally at least, it appears there may be increased openness among sector organizations to these types of arrangements. Umbrella groups may be helpful in identifying possible partners.

Sustainability has been an issue with some past initiatives of this kind. The willingness of organizations to put up with the co-ordinating efforts and compromises needed to make these arrangements work isn't always maintained over time. In addition, in some cases, groups have not been willing to pay for services once seed money provided by external funders for an initiative has been exhausted.

So, it is key for organizations exploring these kinds of arrangements to take a hard look at the cost and other implications of a collaboration for their group. They also need to consider how long they expect it to endure. It may be prudent to start small, rather than being overly ambitious. To avoid disputes over expectations and to provide a means to resolve questions arising in delivery of the service or services, it is best to set out the terms of the arrangement in writing.

Regulatory considerations

There are regulatory concerns when a registered charity shares resources with a non-charity. This could have implications when deciding whether to enter into a shared services agreement. Careful consideration will be needed about the terms of the arrangement to ensure that charitable assets are not being applied to non-charitable activities. Generally registered charities are not permitted to make their resources available to non-charities unless the transaction is at fair market value or the availability of those resources to the non-profit is incidental (minor and a consequence of) the charity's operations. Consult with a lawyer if the arrangement being set up involves both charities and non-charities.

● Restructuring

Another alternative for organizations in financial distress is to restructure and reorganize their projects and activities. Rather than merging and forming a new entity, restructuring allows the organization to rearrange the terms of debts owed to creditors and commitments made to stakeholders, disclaim (renounce) contracts or transfer or sell assets or segments of their work as a going concern.

Informal restructuring

In some cases, it can be in the best interests of both the organization and its creditors to negotiate an alternative to an enforcement action or an insolvency proceeding. To successfully pursue an informal restructuring, the organization must be proactive and collaborative with its creditors. Being open and communicating with creditors when a default is about to occur or has occurred is an important first step.

If resources allow, the organization may engage a restructuring professional for strategic advice on how best to approach creditors and other stakeholders. Where the group can't afford this, it will have to rely on *pro bono* help or the knowledge and experience of its directors and staff. Serious thought should be given to how the organization intends to get adequate support. Saving money by trying to rely entirely on internal resources may end up costing the organization more in the long run.

In the case of charities and non-profits, communication with stakeholders — even though they may not formally be creditors of the organization — is essential. Unhappy stakeholders may cause an organization to fail and undermine its long-term viability, even where it has worked with its creditors to successfully resolve its financial woes. Most charities and non-profits depend heavily on their reputations and these can be easily damaged in a restructuring process.

Organizations should also provide timely and reliable financial reporting as required by any loan agreements. Successful negotiation by an organization in default involves making reasonable requests of their creditors as part of a broader plan. The key objective is to be able to demonstrate that co-operation will likely lead to a 'win-win' outcome for all parties.

An informal restructuring can be achieved in a variety of ways. It can include negotiating settlements for outstanding obligations, waivers of default or negotiating a formal forbearance agreement ([See *What types of creditors will you deal with?* p. 17-19.](#)) An organization's ability to informally restructure can be hampered where there are defaults with different creditors, a significant compromise (rearrangement) of existing debt is required, or the relationship between the parties has broken down. This makes it vital for organizations to have an ongoing dialogue and maintain communication with their creditors during times of financial uncertainty. Maintaining a solid relationship with key stakeholders is key to avoiding a formal proceeding.

As a general rule, organizations should attempt to resolve any outstanding debts that they might have with their creditors and stakeholders before moving on to the formal restructuring proceedings. If efforts to achieve an informal restructuring prove to be ineffective or an arrangement cannot be agreed on between the organization and its creditors, then the formal restructuring alternatives listed below should be explored.

Formal restructuring – *Companies' Creditors Arrangement Act (CCAA)*

Charities and non-profits with debts of \$5 million or more can attempt to restructure their affairs through the *Companies' Creditors Arrangement Act (CCAA)*. The CCAA is federal legislation that allows financially distressed organizations the opportunity to restructure their businesses by developing and proposing a formal plan of

compromise or arrangement with their creditors. In a CCAA restructuring, the debtor (i.e. charity or non-profit reorganizing their company) remains in possession of its property and continues to operate business as usual. A CCAA monitor is appointed to oversee and report to the court and creditors on the organization's operations during the restructuring period.

Depending on the restructuring plan formulated by a debtor, a successful CCAA restructuring may result in the creditors of the organization receiving some form of payment for amounts owing to them in excess of what the creditors would receive on liquidation of the organization's assets.

Formal restructuring – *Bankruptcy Insolvency Act (BIA)*

Charities and non-profits with a smaller amount of debt can also attempt to restructure their organizations through the proposal provisions of the *Bankruptcy and Insolvency Act (BIA)*. The *BIA* is federal legislation that enables financially troubled debtors the opportunity to restructure their business by developing and proposing a formal proposal to their creditors.

Under a *BIA* restructuring, the debtor (i.e. the charity or non-profit reorganizing their company) remains in possession of its property and continues to conduct day-to-day business. To initiate the restructuring process, the organization engages a licensed insolvency trustee to assist it with developing and filing a proposal (a formal agreement presented to creditors setting out how debts will be repaid/compromised). The proposal trustee is formally appointed to oversee and monitor the debtor's operations and financial activities during the restructuring. If a majority of creditors approves the proposal, and it is approved by the court, the proposal is binding on all creditors and the organization continues forward as outlined under the proposal. It is also important to note that there is no specified financial threshold for organizations to restructure through the *BIA*, aside from a modest requirement that the organization must have at least \$1,000 in liabilities.

The following is a detailed comparison between a CCAA reorganization and a BIA reorganization:

Glossary of Insolvency Terms

- Debtor: The charity or non-profit organization that owes its creditors a sum of money.
- Creditor: The person or company to whom the charity or non-profit organization owes money.
- Secured Creditor: A secured creditor is any creditor or lender that holds a registered security interest against the debtor (for instance a loan advance that is backed (or secured) by collateral).
- Unsecured Creditor: An unsecured creditor is an individual or organization that lends money without obtaining specified assets as collateral.
- Insolvent: An organization is insolvent when it is unable to pay its debts.
- Solvent: An organization is solvent when it is able to pay its debts in the normal course of business when they come due.

	CCAA REORGANIZATION	BIA REORGANIZATION
Threshold Requirement to Initiate a Reorganization	Organization must have debts of at least \$5 million to qualify. [see Section 3(1) of the CCAA]	The organization must carry on business or own property in Canada, have liabilities of at least \$1,000 and be unable to pay its debts as they come due. [see Section 50(1) of the BIA]
Monitor/Trustee Appointed	A CCAA Monitor is appointed by the court to assist in filing of a "Plan of Arrangement" and oversee and report to the court and creditors on the debtor's business and affairs during the restructuring process. [see Section 11.7(1) of the CCAA]	A "Proposal Trustee" is appointed to assist debtor to formulate a proposal and oversee and report to the court and creditors on the debtor's business and affairs during the restructuring process. [see Section 50(10) of the BIA]
Purpose	Allows the debtor company to carry out financial and operational restructuring.	Allows the debtor company to carry out financial and operational restructuring.
Debts Compromised	The company will develop a "plan of compromise and arrangement" (a reorganization plan) to present to its creditors in which the claims of secured creditors, unsecured creditors and pre-filing claims against directors can be compromised. Assuming the plan of arrangement has been approved by the majority of creditors and the court, and the company satisfies all components of the plan (e.g. it is fully performed), the debtor company is released from all debts and liabilities satisfied under the plan. [see Sections 4, 5 and 5.1(1) and 6(3) of the CCAA]	The company will develop a proposal (a reorganization plan) to present to its creditors in which the claims of secured creditors, unsecured creditors and pre-filing claims against directors can be compromised. Subject to the proposal being approved by the majority of creditors and by the court, and the company satisfying all components of the proposal (e.g. it is fully performed), the debtor company is released from all debts and liabilities satisfied under the proposal. [see Sections 50 to 66.4 of the BIA]

	CCAA REORGANIZATION	BIA REORGANIZATION
Classification of Claims	For voting and other purposes, creditors with outstanding claims against the company are divided into different groups that have common features and interests (e.g. the type of claim held and the nature and ranking of the claim). Each class of creditors is entitled to vote on the plan except for equity holders (shareholders). [Note: Generally, charities and non-profits will not have any “equity holders”.] [see Sections 6(1) and 22 of the CCAA]	For voting and other purposes, creditors with outstanding claims against the organization are divided into different groups based on the common features and interests (e.g. the type of claim held and the nature and ranking of the claim). Each class of creditors is entitled to vote on the proposal except for equity holders (shareholders). [Note: Generally, charities and non-profits will not have any “equity holders”.] [see Sections 50(1.4), 54 and 58 of the BIA]
Creditor Approval of Plan	To succeed, a plan must be approved by a double majority of each class of creditors. “Double majority” means: (i) two thirds in value of voting claims and (ii) a majority in number of voting creditors. [see Section 6(1) of the CCAA]	Similar to the CCAA as the proposal must be approved by a double majority of each class of creditors. If the majority of creditors reject the proposal, the company is deemed to be automatically bankrupt. “Double majority” means: (i) two thirds in value of voting claims and (ii) a majority in number of voting creditors. [see Sections 54(1) and (2) of the BIA]
Court Approval of Plan	Once the majority of creditors approve the plan, the debtor organization must get approval from the court. If approved by the court, the plan is binding on all the creditors or the class of creditors. [see Section 6(1) of the CCAA]	Once the majority of creditors approve the proposal, the debtor organization must get approval from the court. If the proposal is approved, the terms of the proposal are binding on all creditors. [see Section 58 of the BIA]

Landlord Implications — *Bankruptcy and Insolvency Act*

Proposals to creditors

Section 65.2 of the *BIA* gives tenants who have filed a Notice of Intention the right to disclaim (renounce) a commercial lease in certain circumstances. This provides organizations with the opportunity to more easily reorganize their affairs.

Charities and non-profits going through a formal

BIA restructuring who want to renounce their commercial leases must act within a specific period of time, beginning when the tenant files its Notice of Intention and ending when the tenant files its proposal in bankruptcy. However, the decision need not be made hastily. The *BIA* prevents landlords from terminating the lease by reason of rent arrears owing. The lease continues to subsist while the organization negotiates a proposal with its creditors. The purpose of this section of the *BIA* is to maintain *status quo* among creditors and preserve the organization’s assets

while attempting to restructure. However, the legislation permits a landlord to require rent to be paid for the period after the notice of intention is filed.

If an organization decides that it wants to repudiate its lease, it must provide the landlords with 30 days' notice. After receiving such notice, the landlord has 15 days to apply for a court declaration that the tenant is not entitled to repudiate the lease. The onus then shifts to the tenant to satisfy the court that it cannot make a viable proposal to its creditors unless it can disclaim (renounce) the lease in question.

The compensation payable to the landlord when a charity or non-profit repudiates (or disclaims) a lease in a proposal proceeding under the *BIA* is limited, based on a formula contained in the legislation. The landlord has no claim for accelerated rent, however, its claim for rent arrears is not impacted.

Impact of a bankruptcy proceedings

Once a tenant files for bankruptcy, the landlord cannot take any further steps against the tenant (i.e., there is an automatic stay (freezing) of legal proceedings against the tenant). The landlord is prevented from commencing or continuing any legal action against the tenant for recovery of rent. This includes taking steps to terminate the lease. This follows the overarching purpose of the *BIA*; that is, to provide for the orderly and fair distribution of the property of a bankrupt entity among its creditors.

Below is a summary of landlord's rights on tenant's bankruptcy.

	LANDLORDS CAN	LANDLORDS CANNOT
RENT	<ul style="list-style-type: none"> File proof of claim in bankruptcy Assert priority (i.e., make a preferred claim) for last three months' rent prior to initiation of bankruptcy and three months' accelerated rent following the bankruptcy 	<ul style="list-style-type: none"> Commence or continue legal action against the tenant Terminate the lease Claim priority for rent arrears (other than for last three months' rent prior to initiation of bankruptcy)
SEIZURE OF ASSETS (legally known as "DISTRESS"/"DISTRAIN")	<ul style="list-style-type: none"> Seize assets before bankruptcy Claim compensation for cost of an incomplete distress 	<ul style="list-style-type: none"> Seize assets for rent after bankruptcy Seize assets for rent which pre-dates proposal period
POSSESSION	<ul style="list-style-type: none"> Retake possession if the lease is terminated before bankruptcy 	<ul style="list-style-type: none"> Take possession while trustee holds or occupies premises for up to three months (Note: the trustee is obligated to pay "occupation" rent during the period the property is in the trustee's hands.)

Landlord Implications — Companies' Creditors Arrangement Act

As discussed above, creditor protection under the CCAA is another option available to financially unstable tenants who have claims against them in excess of \$5 million. Landlord remedies are generally stayed (or suspended) upon the court granting an "Initial Order" at the commencement of the proceeding. Under an Initial Order, the organization is required to pay rent under the lease going forward.

As is the case with BIA proposal, the organization has the ability to disclaim (renounce) a lease should it be determined necessary for developing a viable reorganization plan. The landlord is entitled to 30 days' notice of the organization's decision to disclaim the lease. The disclaimer can be disputed by the landlord on the basis that the disclaimer does not enhance the organization's restructuring goal.

Additionally, unlike in the BIA, there is no formula set out in the CCAA for calculating landlord claims in the event the lease is disclaimed by the tenant. However, the restructuring plan will include a formula for compensating the aggrieved landlord.

● Voluntary Assignment into Bankruptcy

Bankruptcy is a legal process by which an organization may be discharged from its debts. A voluntary assignment occurs where an insolvent organization makes an assignment of all its assets for the general benefit of all of its creditors. Once a voluntary assignment is made, a licensed insolvency trustee is appointed and assumes full control of the organization's assets. The assets are turned over to the appointed insolvency trustee on the date of bankruptcy. The trustee's mandate is to inventory all assets and then take steps to liquidate the assets. Once the trustee has completed this process, the trustee reviews creditor claims that have been submitted and distributes the proceeds generated from its realization efforts to the organization's creditors.

The trustee will distribute any proceeds based on the following statutory priority scheme: (i) first, Crown claims and secured creditors; (ii) second, preferred creditors (i.e. employee wage claims and landlord claims); and (iii) third, where there are residual funds, to unsecured creditors on a pro rata basis (distributions are divided proportionately among the creditors, according to the amount of their individual debts).

In order to make a voluntary assignment, the organization must have debts in excess of \$1,000.

Directors should be mindful that a trustee is required to review and investigate all assets of the organization. If significant assets or funds were removed from the organization without sufficient value being paid prior to the bankruptcy, a trustee may take steps to reverse these "reviewable transactions" to bring funds back into the bankruptcy estate for the benefit of creditors.

● Winding Up/Dissolving

When a registered charity or non-profit organization can no longer operate for financial reasons, it can pass a resolution to wind up. This does not terminate the organization's corporate status, but generally as of the date of that resolution the organization does not continue to carry on its business except as necessary for its beneficial winding up and liquidation of assets. Essentially this means it can carry on only to the extent that is necessary to have a smooth shutdown.

In conjunction with the decision to wind up the organization, some form of public notice may be required to alert the membership, donors or creditors of the wind up. As part of the wind up process, the organization would arrange to pay its outstanding liabilities and then distribute any residual funds in accordance with the terms of the corporation's governing documents. It is important that tax advice be sought as part of this process to minimize any risk for the directors and officers. Depending on the organization's tax status, there may be specific restrictions

that apply to the distribution of assets. Lastly, the corporation would need to ensure any final corporate and/or tax information returns are filed.

When a corporate charity is wound up, the charity is obliged to stop carrying out its charitable work to proceed with winding up the charity.

Where a liquidator is appointed to complete the wind up, the directors' powers cease to exist, except to the extent required by the liquidator, and the liquidator has the power and authority to deal with the assets of the organization, with the approval of the court. Unlike in a bankruptcy proceeding, title to the assets of the organization is not transferred to the liquidator. However, the liquidator has the power and authority to deal with the assets with the approval of the supervising court.

Dissolving the Corporation

In conjunction with winding up the organization, where the organization is a corporation, a voluntary dissolution should also be undertaken. Dissolution is the termination of corporate existence under corporate law. Upon dissolution, the corporation ceases to be a legal entity.

Under the *CNCA*, a voluntary dissolution must be approved by the members of the corporation. At the time of dissolution, the corporation will have no liabilities and will have distributed all of its remaining property in accordance with the *CNCA*.

The decision to dissolve must be approved either, by special resolution of the members or, if the corporation has more than one class or group of members, by special resolution of each class or group whether or not the members are otherwise entitled to vote or by unanimous resolution of the board of directors if the corporation has not issued any memberships. Section 221(3) of the *CNCA* allows a corporation to liquidate and dissolve by special resolution of each class of members regardless of whether or not they are entitled to vote.

A voluntary liquidation and dissolution under

section 221 is used when the corporation has property and needs to appoint a liquidator. In some cases, a corporation will be able to sell off its assets and discharge its liabilities under the guidance of its board of directors, thereby avoiding the expense and time of appointing a liquidator.

As part of the dissolution process, an incorporated non-profit or charity must get consent from the appropriate government entity. A non-profit or charity must get consent from the applicable corporate department (where it is federally incorporated, Corporations Canada; for a provincially incorporated not-for-profit, the applicable provincial ministry). A registered charity must also complete filings with the Canada Revenue Agency (CRA) and, if applicable, the Ontario Public Guardian and Trustee or its provincial equivalent before the corporate dissolution will be granted.

Dissolution under the Canada Not-for-profit Corporations Act (the *CNCA*) is discussed below. Dissolution procedures under provincial corporate legislation and under other federal corporate statutes vary and are not discussed here. Again, appropriate legal advice should be sought to ensure you comply with all the applicable requirements. Once the decision to dissolve the corporation is final, a director or authorized officer of the corporation must prepare and file the articles of dissolution (Form 4017) with the Director of the *CNCA* ([See Appendix B for materials related to this process, p. 35.](#))

Procedures and filings for dissolution under provincial corporate statutes differ, and some are more complex than others. A corporation must be dissolved as set out in the legislation or regulations of the statute under which it was constituted. Corporate dissolution as a result of failure to file annual returns generally takes two or three years, sometimes longer. Practice varies by jurisdiction. During the period in which a corporation is not formally dissolved, directors may be subject to penalties for neglected filings

or to being named in legal claims against the corporation.

Distribution of Property of Dissolving Corporations

For *CNCA* corporations, once an organization has passed a resolution to wind up, the manner in which its property is distributed to its creditors or others depends on whether the entity was a “soliciting” or “non-soliciting” corporation. In some cases, *Income Tax Act (ITA)* status will also affect what happens to assets.

If the corporation is not a registered charity or other entity for which there are specific *ITA* distribution rules, the following rules generally apply in descending order: Secured creditors must be paid; property that a person has transferred to the corporation on the condition that it will be returned on dissolution must be transferred back; liabilities of the corporation must be satisfied; and the remaining property must be distributed in accordance with the corporation’s articles, or if the articles are silent, to the members on an equal per capita basis.

Revocation of registered charity status and distribution of a registered charity’s assets

If the dissolving entity is a registered charity (whether a corporation, trust or unincorporated association), additional rules apply. The entity must seek revocation of its status from the CRA. The sequencing of dissolution, winding up and revocation may depend on the legal form of the entity, so regulators and/or legal counsel should be consulted on the order in which various steps ought to be taken. ([See Appendix B for information on revocation procedures, p. 35.](#))

The *ITA* regulates certain charity-like groups known as “qualified donees”. Some of these entities are bound by dissolution and assets distribution rules similar to those of registered charities. Again, it is recommended that those involved seek legal advice if the entity may be subject to *ITA* obligations in this regard.

Among other considerations, upon revocation of a registered charity or of some categories of qualified donees, remaining property must be distributed to other qualified donees. A qualified donee is defined in the (*ITA*) and includes the following:

- A registered charity;
- A registered Canadian amateur athletic association;
- The government of Canada, or a province/territory;
- The United Nations or an agency of the United Nations;
- A tax-exempt housing corporation resident in Canada that is registered by the Minister of National Revenue;
- A registered Canadian municipality;
- A municipal or public body performing a function of government in Canada that has applied for registration with the Minister of National Revenue;
- A university outside Canada that is prescribed under the *ITA* to be a university;
- A foreign charity that has applied to the Minister of National Revenue for registration; and
- A registered journalism organization.



Part IV: Ceasing Operations Informally

Is walking away an option?

It is not uncommon in the voluntary sector for organizations to cease operations rather than formally winding up or dissolving. This is not good practice.

When an informal shutdown occurs, it commonly happens in one of two ways. The first is that the directors resign and abandon the entity. The second sees directors remain but stop the organization from operating. After a period during which there is no activity or if regulatory filings are neglected, legal status may lapse.

Directors should carefully consider their position if the possibility of ceasing informally is raised. Directors who resign are not necessarily released from possible liability for events that occurred while they were on the Board. The decision to step down, although attractive, may not be the best one for the director or the group.

Directors of voluntary sector organizations are not entitled to any more lenient treatment with respect to statutory liabilities, even though they often serve without remuneration. Though they can try to negotiate to be released from these responsibilities, there is no legal basis for this. Some statutory liabilities are intended to offset the losses that stakeholders, such as employees, would otherwise suffer, so there may not be much room for negotiation or flexibility.

That said, some or all directors of organizations that are folding may resign before the procedures for winding up or dissolving the organization are completed. Where the board is not receiving adequate financial information to make decisions (as often happens when organizations are in significant difficulty), and management is unable or unwilling to fix this, directors may believe they have little choice but to resign. There may also be other structural issues that prompt resignation of a director or directors. The problem is resigning may not always be the best answer in response to this type of dysfunction, and there may be other steps the director or board can take to address the problem. Appropriate legal advice should be obtained before any steps are taken.

Faced with some of the statutory liabilities that board members may be subject to when an organization folds, directors may also reason that their financial self-interest requires that they give up their post. However, depending on the resources of the organization and the insurance that is in place, this may not mean the director will be protected. In fact, remaining on the Board could be better protection for all involved. Directors who resign are potentially liable and continue to have obligations for the period in which they served as a director.

If a director does decide to resign, in order to ensure that any resignation is effective and publicly known, the resignation must be filed with the corporate registry. Other regulatory filings should also be updated.

Directors who disengage but do not resign, or whose resignations are not reported in the necessary filing(s), may find themselves subject to claims or other court proceedings even if they were not carrying out their functions as a director during the time at which the legal action arose. Having resigned as a director likely means any indemnification provided for in bylaws will not be available. And, in this context, it should be kept in mind that even claims without legal merit still have to be defended.

Stepping down might also impact the available insurance coverage. Most Directors and Officers insurance policies are claims-made, rather than occurrence-based. (Occurrence-based coverage applies to conduct or events during the term of the policy; claims-made depends on the timing of the claim and does not cover the claim if the claim is filed outside the policy period.) This means that unless the coverage is extended through a supplementary policy, directors and officers will not be protected from claims made after they leave office. So, walking away without making sure the needed paperwork is completed can be costly.

Ex-directors or directors will have to pay for the cost of defending themselves and satisfying any judgement or settlement in any actions brought when no insurance was in place. Similar considerations may apply to Errors and Omissions policies. Further, some Directors and Officers insurance policies cover statutory liabilities triggered by bankruptcy or dissolution. Directors who leave prematurely can lose the benefit of this coverage.

Leaving aside the question of directors stepping down, there are broader regulatory and operational implications to simply abandoning activity.

It should be remembered that a charity or non-profit organization is established and operates to serve a need. By their very nature, that need will be something other than making money. So even if the current organization disappears,

it is important to maintain the goodwill of stakeholders to allow another organization to be created some time in the future and again address the need. It is common that when that happens, many of the same players — suppliers, volunteers, personnel, etc. — will be key to any relaunch and maintaining their trust through an orderly shutdown is important.

There are many reasons — both from an organizational standpoint and from the perspective of being a director — to see the wind up of operations through to its completion rather than abandoning ship.

For example, while a corporation is subject to being struck off a federal or provincial corporate registry for failing to submit its annual filing, this does not happen immediately. It is generally a lengthy process and only happens after the organization has failed to file its annual returns for at least two or three years. In the meantime, the corporation is still a legal entity and, though inactive, is subject to the same rules as an active company. Individuals who remain on the Board or on record as on the Board of a dormant organization may be exposed to some risk.

And similarly, failure to file the annual charity T3010 form or failure to inform CRA that the organization no longer operates and is relinquishing its charitable status, in the case of a registered charity, exposes an organization to having its charitable status revoked, and this may give rise to tax liability and to obligations about how the organization disposes of its assets.

Finally, where public records are not updated, this increases the risk that an individual or company dealing with the organization in good faith may be misled about the organization's situation. If this has consequences in terms of a contract or other arrangement with the organization, it may prompt a legal action.



Conclusion and Appendices

After reading through this Guidebook your charity or non-profit organization should be prepared to navigate through these uncertain times. No matter what course of action you decide, remember the importance of the following fundamentals:

- 1. Be honest with yourselves, your organization, and your stakeholders. Be transparent with your organization and key stakeholders; and*
- 2. Focus on building strong relationships with stakeholders. Remember, your stakeholders, whether they be employees, donors, or other creditors, share an interest in you succeeding. If possible, they will want to continue their relationship with your organization and for it to be able to carry out its purposes. Consider your stakeholders allies and treat them as such.*

APPENDIX A

Compliance Certificate Sample

MEMORANDUM

DATE: _____

TO: The Board of Directors

FROM: _____, Executive Director

SUBJECT: Compliance Certificate

As President & C.E.O. [or Executive Director] of the [Name of Organization], I confirm that for the period ending _____, the following has taken place:

1. all salary and wages have been paid when due in respect to all employees of the [Organization];
2. all statutory deductions relevant to the payment of salary and wages have been made and remitted in a timely manner;
3. applicable Goods and Services Taxes have been properly calculated and remitted to Canada Revenue Agency;
4. insurance premiums and lease payments respecting the property and operations of the [Organization] have been made and remitted in keeping with the applicable contracts; and
5. staff expense claims have been reviewed and determined to be consistent with [Organization] policies.

In confirming this information to you I have reviewed and relied on the reports prepared in conjunction with the [Organization's] record keeping.

[Signature]

APPENDIX B

Additional Resources

Canada Revenue Agency Charities Directorate, *Amalgamation, merger, and consolidation*,
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/making-changes/amalgamations-mergers-consolidations.html>

Canada Revenue Agency Charities Directorate, *Winding-up period*,
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/summary-policy-w03-winding-period.html>

Chartered Professional Accountants — Canada, *Annual reporting for not-for-profit organizations*,
<https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/not-for-profit-organizations/publications/annual-reporting-for-not-for-profit-organizations>

Chartered Professional Accountants — Canada, *Not-for-profit Governance publications*,
<https://www.cpacanada.ca/en/business-and-accounting-resources/strategy-risk-and-governance/not-for-profit-governance>

Industry Canada, *Dissolving a not-for-profit corporation*
<https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs05167.html#howcan>

The Muttart Foundation, *Restructuring Program Applications*,
<https://www.muttart.org/charitable-activities/strengthening-the-charitable-sector/>