



Advisory

To Boards of Directors of Not-for-Profit Corporations.

Regarding agency management when significant agency funding is withdrawn on short notice.

Deep government funding cutbacks to not-for-profit agencies continue to take place. The additional complication, which has taken organizations by surprise, is the very short notice period being given. In some instances notice is as little as sixty days. This short time period places tremendous pressure on Boards of Directors and they need to be on top of the situation if they are to manage their conflicting responsibilities to clients, staff, creditors and other funders.

This advisory has been prepared to provide Boards of Directors with some beginning advice on things they should be aware of when dealing with sudden funding cuts in their own organizations. While every attempt has been made to provide factual and accurate advice the sudden withdrawal of funding from not-for-profit organizations has not been a common or frequent practise and the full complexities and implications are not yet known.

THIS ADVISORY DOES NOT REPLACE THE EXPERT LEGAL AND FINANCIAL ADVICE EACH AGENCY WILL NEED FOR THEMSELVES. THE INFORMATION IN THIS ADVISORY SHOULD NOT BE USED AS THE SOLE BASIS FOR DECISION-MAKING.

Take Stock of Assets and Liabilities

Boards of Directors of not-for-profit organizations receiving government funding should immediately review in detail their assets and liabilities. When funding continues from year to year assets and liabilities can be handled through the routine cash flow. When funding is suddenly withdrawn these liabilities take on a new importance.

The following is a guide to some of the key information Boards of Directors will need to make decisions about their agency.

Assets

Funds in the Bank and investments	<p>Note which funding source it belongs to. You may have separate and distinct obligations to each funder and may not use their funds for other purposes.</p> <p>Each funder contracts for a specific service and using the funds for a different purpose e.g. to pay severance or creditors of another service would violate the terms of the contract. It will be important to revisit the wording of the agency's contracts to determine what kind of flexibility/inflexibility the agency may have in meeting its obligations.</p>
Owned Equipment	List and estimate its current value.
Real Property	<p>Be careful in estimating the worth of property bought with government money. Who really has title to the property, the agency or the government? The property likely has conditions in the purchase agreement which prevents the agency mortgaging or selling it without the government's approval. If, however, the agency enters into bankruptcy and has title to the property it appears the government may be just another creditor. You will need legal advice on your own situation.</p>
Accounts receivable	<p>What funds can the organization expect to receive? Be cautious about counting on other funders to continue their funding. Depending on the size of cut you sustain your other funders might decide you are not viable and withdraw their funding too.</p> <p>You need to clarify your obligations with your funders to understand what, if any, flexibility you have to deploy funds to meet the organizational obligations associated with closing programs down or meeting ongoing operating costs. e.g. higher rent for remaining programs.</p> <p>It would be prudent on an ongoing basis to keep other funders informed on how you are dealing with your funding cut and reassure them, you will be honouring their contract.</p>

Liabilities

Bank indebtedness and loans	Some agencies are already over-budget and have lines of credit at the bank. These agencies need to be very careful as they will have even less ability to meet payroll obligations.
Accounts Payable	<p>Boards of Directors will want to ensure all monies owed to the Receiver General or provincially to the Minister of Finance for payroll taxes, UIC, employer health tax etc have been paid and remain paid up. As a member of the Board of Directors you are jointly and severally liable for these remittances if they have not been paid. (If you have directors and officers liability coverage find out if it will cover directors for such costs.)</p> <p>You will need a list of accounts payable to help sort out who your creditors are, and how much you owe. This information is important in determining whether you can stay in business or whether you should be considering entering into bankruptcy.</p>
Contracts	<p>This includes all signed contracts and lease to purchase agreements. Check if any have early termination clauses or specify the costs of termination. If you are trying to stay in business this information is important as you may need to negotiate with them. If you are closing down then the holders of the contracts become unsecured creditors.</p> <p>Calculate the value of each of the contracts. For example if you have four years left on your lease how much do you owe until the end of the lease? Remember to include service contracts with consultants, snow shovelling etc.</p> <p>Do you have employees with contracts? What are the termination provisions? Ensure you can meet them. This applies to contract staff and those with union agreements. If you cannot meet them then you have to negotiate your way out of them or you will be looking at the agency closing down.</p> <p>With certain contracts paid in advance, such as insurance you might be able to claim a partial refund.</p>

Salaries and benefits	<p>What amounts do you owe? Directors are liable for wages for work completed. Pay attention to the timing of payrolls. Some agencies pay one or two weeks in arrears. Be sure to calculate the payroll remittances on this money too. Remember to calculate holidays earned to date or carried forward from prior years (Directors are personally liable under the Corporations Act for up to six months of wages and one year of accrued holidays.)</p>
Notice and Severance	<p>Notice and severance provisions are set out in the Employment Standards Act. If an agency is discontinuing its operations they are obligated to give one week notice for every year of employment to a maximum of eight weeks and to pay severance to employees with service of 5 years or more (1 week per year to 26 weeks). Employees may be covered under the Employee Wage Protection Plan should an agency default on its notice and severance obligations. (You will need to consult the Employment Standards Act for the exact details of notice and severance provisions).</p> <p>Under common law employees are eligible to pursue claims for loss of employment. If the agency intends to continue with some service delivery they will need to pay severance payments due under common law. These are typically more than the severance provisions set out in legislation for discontinuance of a business. Union agreements regarding termination notice would have to be honoured if the organization is staying in operation.</p> <p>Directors are not personally liable for severance or notice (except for that part of the notice period an employee has worked.) You need to be very careful in calculating amounts owing to employees and in making sure the corporation has assets to cover wages, employee/employer remittances and termination pay.</p>

Even if you do not think you will receive deep cuts from funders it would be wise to calculate the assets and liabilities of your organization. Once the organization is destabilized it will be important to have this information to help with decision-making.

Directors and Officers Liability Insurance.

Many agencies have directors liability insurance and you should have your policy assessed for the types of coverage it offers. The insurance should cover the amounts owing personally by directors after the organization has done all it can to pay the wages owing. Be careful; the insurance does not usually cover you if there has been any quasi-criminal wrong doing e.g. violating provisions in legislation for which penalties are fines or jail terms.

Be aware of the notice provisions in your policy and report potential claims in a timely fashion to your insurer.

Resignation Of Members of Boards Of Directors

It has occurred before that Boards of Directors when faced with very unpleasant and difficult situations have wanted to resign and leave the government with the problem. While this is a natural feeling it is not technically feasible. A not-for-Profit corporation is an independent entity. The government cannot step in to an organization unless yours is a corporation with special interests e.g. the safety of children in child welfare. In this case the provision for takeover is specifically provided for in legislation. Even then, the government has only stepped in when there are serious issues of safety involved.

You are the directors unless you resign or until the membership of the organization replaces you at a special meeting called for that purpose or at the annual meeting. If the organization loses a quorum of directors, a membership meeting must be called to elect new directors. The bottom line is - the organization through its directors is responsible for its own affairs.

Most directors need not worry unduly if they act in good faith and make decisions to the best of their ability.

Responsibilities to Clients

It is a good idea at this point to develop a plan for dealing with clients. The agency has been charged to provide services to clients. Though there are probably no provisions in your funding contracts specifying the kind of notice you need to give clients to withdraw services, there is a moral obligation many directors of organizations may feel to be as compassionate as possible with clients. The agency should develop a plan for notifying clients of cessation of service and identify the notice period they would like for each program. The agency should also determine whether any other action should be taken e.g. referral of client to alternate service. Some clients are vulnerable and attention will need to be paid to service withdrawal.

Client considerations may influence decisions regarding the timing of program closure, though financial considerations will ultimately drive the process.

Courses of Action

Once you have the financial facts before you the Board of Directors is in a better position to determine a course of action. You have three basic choices, to try to stay in business, to close down the whole agency, or to try and salvage a part or parts of the agency for which funding is still available.

Stay in business

If you are going to stay in business you will need to figure out a way to honour all your liabilities.

Agencies wishing to stay in business may need to negotiate with their contract holders. You may be able to ask for concessions from contract holders to lighten your obligations e.g. perhaps a landlord might reduce your rent or the phone company might renegotiate your lease to purchase etc. Unions may agree to open a contract for renegotiation. These groups may wish you to remain in business rather than go bankrupt.

You might be able to reorganize your programming and approach other supportive funders to see if they would consider helping you out or letting you change the terms of your contract with them to enable you to meet your obligations. This will be possible only if the cuts are not too overwhelming. Some funders may be interested in saving some agency infrastructure as they need organizations to deliver their programs.

If you are going to try to stay in business you need to be in close contact with your funders to ensure they know of your plans and are supportive.

The shorter the time period the more difficult it will be to put together new arrangements. As you negotiate remember to keep an eye on your bottom line. Directors cannot afford to let the agency make termination decisions too late. They must ensure the funds are there for wages and associated termination costs.

Salvage Programs/ or merge agency

As an alternative to having the whole organization involved in the bankruptcy your Board of Directors may decide that it wants to try and save a part of the agency's services by negotiating a salvage operation with another more stable service. In this case you would negotiate with the agency and funder for the transfer of funding to the new organization. You may want to transfer the program in its entirety including physical location, staff and clients to the new program. There may also need to be

negotiations with contract holders e.g. landlords to transfer the lease agreement.

You will need legal advice about the feasibility of moving a separately funded program out of the corporation if the corporation will be going out of business. There is legislation called the Bulk Sales Act which seeks to prevent companies from emptying a corporation in trouble of its assets; this legislation may apply in the circumstances. A key factor in deciding whether this splitting off of still funded programs is possible is the terms of your funding contract.

The reason you may want to undertake this kind of negotiation would be if you had particularly vulnerable clients who required continuity of care, or if the program had very special physical plant needs or special zoning which would be lost forever if included in a bankruptcy. The funder can always stop funding and reallocate the funds to another agency but the physical plant and equipment may be lost and the clients would suffer discontinuity.

Close down

If all your funding has been pulled or the cuts are so deep your liabilities will overwhelm the corporation you need to think about closing down. You might at this stage consider hiring a Trustee in Bankruptcy (starting cost \$5000). What formal bankruptcy proceedings will do for your organization is bring all the decision-making into the open. The Board of Directors would give decision-making over to the trustee. It is the trustee who determines who gets what money from the corporation. An alternative to a bankruptcy trustee is a liquidator who would negotiate with your creditors on your behalf. With a liquidator the Board of Directors could still be caught in disputes and litigation about the fairness or unfairness of decisions.

If an agency has to close its doors it needs to determine how it will go about it. The Directors will need legal and accounting assistance to make these decisions. Directors will need to balance their obligations to clients, staff, funders and creditors.

The material in this advisory was originally prepared for the United Way of Greater Toronto by Lynn Eakin of Lynn Eakin and Associates. Both parties have distribution rights with attribution to author and sponsor.

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