

RISKS OF BEING A CHARITY TRUSTEE

Introduction

There are a number of reasons why charity trustees have become increasingly concerned about the extent of their potential liabilities.

The first is that the Charities Acts of 1992 and 1993 impose a much greater degree of accountability for charity trustees generally than was the case before. New fundraising and other charity law legislation has increased the regulatory burden on trustees and non-charity specific legislation such as employment and health and safety legislation has introduced greater duties on trustees, most of whom are part time volunteers and who are not remunerated for their services.

The Charity Commission is also increasingly active in supervising the activities of charities and investigating cases where they consider that charity trustees have not acted in accordance with their duties. Charities are required to file an annual return and accounts with the Charity Commission which will look into irregularities which it finds. The Charity Commission is also conducting a greater number of review visits when the operations of a charity are reviewed as a whole. Allen & Overy has been instructed in recent years in a number of cases where the Charity Commission has opened an investigation into a charity and its affairs and where the trustees are themselves at risk of personal liability.

Another reason for the concern being felt by charity trustees is the fact that a number of operating charities in recent years have faced financial difficulties and a number have been and are being forced into liquidation, sometimes in circumstances where there will be considerable doubt as to whether their assets will meet their liabilities, leaving potential personal liabilities for their trustees. Many charities are still constituted as trusts or unincorporated associations leaving their trustees very exposed to the risk of personal liability in contractual situations. The activities of charities (particularly operating charities) are becoming increasingly complex often with the result that these more sophisticated activities carry a greater risk.

There is also an increasing concern about potential liabilities for trustees of operating charities to visitors to the charities' property or beneficiaries of the charity.

Finally, the perception and reality that UK society is becoming increasingly litigious and the introduction of contingency fees for lawyers is causing concern among charity trustees.

Who is a charity trustee?

Section 97 of the Charities Act 1993 defines "charity trustees" as being persons having the general control and management of the administration of a charity.

Therefore any person who has this degree of control over a charity will be a charity trustee for the purposes of the Charities Acts. Depending on the way in which a charity is constituted (for example, as a company or trust), the decision makers will be "charity trustees" for legal purposes irrespective of whether they are known as directors, trustees, council members or governors.

Care should be taken to ensure that too much management control is not given to other parties with the result that they could inadvertently become charity trustees.

Contractual liability and liability for breach of trust

Charity trustees face potential liabilities in a number of ways.

Probably the area where charity trustees face the greatest risk of personal liability is where they act in breach of duty or in some way negligently or fraudulently. Charity trustees have duties imposed on them by general common law and by statute (including both legislation which applies specifically to charities such as the Charities Acts and more general legislation such as employment legislation or health and safety legislation which will be relevant where the charity in question employs staff). The checklist (discussed below) gives examples of the type of situations where trustees are liable for breach of duty. Where loss is caused as a result of a trustee's breach of duty, the trustee will be required to make good that loss out of his own resources.

Charity trustees risk personal liability where they are in breach of duty or act negligently irrespective of whether the charity itself is a corporate or an unincorporated body.

The other main area of concern is contractual liability. If trustees fail to comply with the terms of a contract (even if they have acted entirely properly) a liability can arise.

The risk in respect of contractual liability depends on how the charity is constituted.

Where the charity itself is a company, then contractual liabilities to third parties will be limited to the value of the company's assets. Provided the trustees (i.e. the directors of the company) have acted properly they will face no personal liability even if the assets of the company are insufficient to meet the claim.

Where the charity is an unincorporated body such as a trust or an unincorporated association, it is the charity trustees themselves who are parties to the contract. Therefore, if the third party makes a claim for breach of contract the trustees will be personally liable to make up any shortfall where the assets of the charity are insufficient to meet the claim. The same is true in respect of tortious liability where trustees of unincorporated charities can face personal liability even if they have acted reasonably and with due care if the charity's funds are not sufficient to meet the full claim.

In contractual situations trustees can lose their ability to have recourse to the trust fund where, even if the trust assets are sufficient to meet the claim and the trustee has acted properly in relation to the contractual claim, they are otherwise in breach of trust in connection with some other matter.

An example of this in relation to contractual liability is the case of **Marston Thompson and Evershed v Bend & Others** (19th September, 1997, unreported). Although the trustees in question were not charity trustees, the same principles applied. In that case the plaintiffs lent money to four defendants who were trustees of club property, to finance the building of a new clubhouse. The defendants entered into the loan agreement and a charge was taken by the lender over the club property which was held in the names of the trustees. The defendants were expressly stated in the loan agreement to be trustees. The club failed to repay the debt and the lender's security was insufficient to meet the obligations under the loan.

The lender claimed against the trustees personally, and the trustees defended the claim on the basis that the loan should be satisfied out of the assets of the club held at that time by the trustees.

The court in this case held that the trustees were personally liable for the whole amount of the debt. It was held that the trustees being described as such in their loan agreement does not limit their liability.

Joint and several liability - it should be noted that a trustee is only liable for his own acts or defaults and not for those of his co-trustees (Trustee Act 1925 s.30). Each of the trustees actually involved in

a breach of trust is personally liable for the whole of the resulting loss, regardless of the degree of blame attaching to him. An example, is where one trustee allows a co-trustee to control trust funds and the co-trustee misapplies them. The trustees will be equally liable even though the involvement of the first trustee has been passive only. (**Wilkins v Hogg** (1861) 31 L.J. Ch 41). The passive trustee has failed to exercise proper care over the assets.

If only one of the trustees concerned in the breach of trust is sued he will be entitled to contribution (or in some cases, an indemnity) from his co-trustees except where he has been found guilty of fraud.

So what can be done to improve the contractual position for trustees of unincorporated charities?

Charities which are likely to enter into contractual commitments or undertake activities and operations which could give rise to personal liabilities for trustees (such as schools or hospitals) should be set up as corporate bodies to avoid this difficulty arising. We tend to recommend to clients setting up charities that where the charity is going to be an operating charity, undertaking activities and contractual commitments, then the charity should be a corporate body. Trustees of some grant-making charities may take the view that they are unlikely to enter into any substantial contractual commitments and so may prefer to be constituted by trust.

Charities which are already set up as unincorporated charities can incorporate if their trustees are concerned about the risk of contractual liability.

If the trustees of an unincorporated charity enter into contractual commitments they should consider expressly limiting their liability under the contract to the assets of the charity from time to time.

It should be noted that incorporation only protects against contractual liability or tortious liability but provides no protection where charity trustees are in breach of their duties.

Other methods of protection for charity trustees are considered later.

Retirement of Trustees

Another risk which is particularly relevant to trustees of charitable trusts (as opposed to directors of charitable companies) is the risk of liability after retirement. A trustee does not, on retirement, cease to be personally liable under a contract he has entered into while a trustee. His personal liability

continues and on his death his personal representatives assume his responsibilities. Once a trustee has retired he no longer has the trust funds under his control and this increases his risk of exposure.

In order to protect themselves, trustees should have built into their long-term contractual arrangements a provision that a retiring trustee will cease to be liable under the contract on his retirement as a trustee, provided that his replacement trustee steps into his shoes and takes on the liability in his place.

Checklist for Charity Trustees

In an attempt to try to identify some of the areas in which charity trustees have personal liabilities, 50 questions have been prepared which are rather like an MOT and could be put to trustees. These questions highlight various areas of risk and suggest some ways in which charity trustees may legitimately protect their position.

One of the best methods of protection against personal liability is for charity trustees to have a full understanding of their duties and to comply properly with them. As a general rule, where trustees have acted properly they can avoid personal liability.

The standard of care required of a charity trustee generally is that of an ordinary prudent man of business in relation to his own affairs. (**Re Luckings Will Trust** [1968] 1 WLR 866). A higher standard of care is required where the trustee is a professional who is paid for his services.

The Trustee Act 2000 has introduced a new statutory duty of care which applies when trustees exercise certain powers specified in the Trustee Act 2000 including their power of investment.

Section 1 of the Trustee Act 2000 provides that:

"Whenever the duty under the subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular

- (a) to any special knowledge or experience that he has or holds himself out as having, and

- (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession."

The position for directors of charitable companies is more complicated in that generally company directors are subject to a lower standard of care than trustees. However, where the courts have considered the position of directors of charitable companies they have regarded them as being in the position of trustees and fiduciaries and subject to a corresponding higher duty of care. (**Re French Protestant Hospital** [1951] 1 Ch 567).

The checklist questions are as follows:-

1. **Do the Trustees know whether their charity is incorporated or not?**

It sounds obvious but charity trustees in some cases may be unaware of whether they are trustees of a charity which is incorporated as a company and which (as discussed above) will give them a much greater degree of protection against potential claims or whether they are trustees of a charity which is an unincorporated association or a trust in which case they are personally liable in contract and tort for claims made against the charity. It is fundamental that they should ascertain their position and (if appropriate) give consideration to the possibility of incorporation.

2. **Have the Trustees seen the charity's constitution and do they understand it?**

Again this seems a simple question but many people accept trusteeship without having sufficient information about what rules govern the charity and having accepted trusteeship never make any enquiry about this until perhaps too late.

It is essential that each trustee should be fully aware of what is in the governing instrument of the charity so that he or she knows what is and what is not permitted.

To act otherwise than in accordance with the terms of the governing instrument is potentially inviting claims for breach of trust.

Each trustee should keep a copy of the charity's constitution.

3. **Are minutes kept of Trustees' meetings and are they approved at the next meeting of the Trustees?**

No comment is necessary about the importance of this.

4. **Do the Trustees know the identity of those besides the named Trustees who might be charity trustees of the charity?**

Again this seems a simple question.

However a report of the working party on charity trustees set up by the NCVO found that two-thirds of charity trustees were unaware that they were charity trustees in many instances because they were called by some other title.

It is essential that trustees should know who are the charity trustees of their charity.

As referred to above, "charity trustees" are the people responsible under the charity's governing document for controlling the management and administration of the charity regardless of what they are called.

5. **Do Trustees know the grounds for disqualification from being a charity trustee?**

Sections 72 and 73 of the Charities Act 1993 provide that a person is disqualified from acting as a charity trustee if:-

- (a) He has been convicted of an offence involving dishonesty or deception.
- (b) He has been adjudicated bankrupt.
- (c) He has made a composition with his creditors and has not been discharged.
- (d) He has been removed from office by the Commissioners.

- (e) If he is disqualified from acting as a director of a company by an order made under the Company Directors' Disqualification Act 1986.

6. **Do Trustees know how new Trustees are selected and appointed?**

The charity's constitution will set out the procedure for the appointment of trustees. This should be studied because the power of appointment is sometimes held with outside bodies. It is essential that trustees should be selected not as has happened often in the past as an honour but for what they can bring to the charity and their commitment to it.

7. **Do Trustees know whether they have a specified tenure of office as a Trustee?**

Trustees will either be appointed for a fixed term or for an indefinite period and they should know whether their fellow trustees are supposed to retire or have retired by a certain time.

It is often the case that where fixed periods of office are provided, those fixed periods are forgotten and people continue as trustees without proper appointment.

It is therefore essential that each trustee should know precisely the period for which he or she has accepted office.

8. **Do the Trustees know the charitable objects of their charity and are they acting entirely within the objects?**

These are set out in the governing document.

The trustees have a duty to act within the charitable objects of the charity and to apply the assets of the charity exclusively in the promotion of those objects.

It is a breach of trust to undertake any activities which lie outside the objects of the charity.

9. **What are the main duties of charity trustees?**

Charity trustees are volunteers who have to set aside their personal interests and give their time and carry out their duties for no payment (except in rare circumstances).

The overriding duty of charity trustees is to act in the best interests of the charity.

Their main roles are to:

- Ensure that all the charity's activities are permitted and within its charitable objects.
- Determine the best method of fulfilling the charity's purposes.
- Develop the charity's policies.
- Ensure that the charity has adequate resources.
- Ensure that the charity's property, assets and other resources are protected and managed efficiently.
- Ensure that the charity fulfils its accountability as required (e.g. to the Charity Commission, the Inland Revenue, Customs & Excise, the Registrar of Companies and to staff).
- Appoint staff (where appropriate) and to review the performance and emoluments of the staff.
- Ensure that they do not profit from their position and do not place themselves in a conflict of interest situation.

10. **Do the Trustees know in what circumstances they can delegate authority for a particular aspect of the charity's work to committees or staff?**

If the charity's constitution gives the power to do so, the trustees may delegate authority to a committee or individual for a particular aspect of the charity's work.

However any decisions made by such committee or individual remain the responsibility of all the trustees and where important issues are concerned it is advisable that those committees or individuals should make recommendations to the trustees but that the decision as to whether or not to act on those recommendations should be taken by the trustees as a whole.

Legislation such as the Trustee Act 1925 and the recent Trustee Act 2000 provide certain default powers of delegation although the 2000 Act provides more limited powers of delegation for charity trustees than trustees of private trusts.

Section 11 of the Trustee Act 2000 allows charity trustees to delegate only "delegable functions" being:

- (a) any function consisting of carrying out a decision that the trustees have taken;
- (b) any function relating to the investment of assets subject to the trust (including managing or disposing of land); and
- (c) any function relating to the raising of funds for the trust otherwise than by means of profits of a trade which is an integral part of carrying out of the trust's charitable purposes.

Trustee may have more extensive powers of delegation given to them by the constitution of the charity.

The Trustee Act 2000 is generally not relevant to charitable companies except where the charitable company is holding assets on special trusts (separate from the corporate assets of the charity). Directors of charitable companies should therefore look to the memorandum and articles of association to determine the extent of their power to delegate.

The terms of reference and the reporting back procedures of any delegates should be laid down in writing and agreed by the trustees.

Similarly if the charity is of sufficient size and its governing document gives the power to do so, the trustees may delegate the day-to-day management of the charity to its staff.

The scope of delegated authority should be laid down in writing and decisions made by staff on important matters should be reported to the trustees as quickly as possible.

The trustees remain legally responsible for all the activities of the charity including matters delegated to staff.

11. **Do the Trustees meet regularly and are the papers for each meeting thoroughly prepared?**

Trusteeship is a serious responsibility requiring trustees to take an active role in the governance of the charity.

The only way in which they can do this effectively is by ensuring that regular meetings of the trustees are held and that the papers for those meetings are thoroughly prepared so that all trustees attending the meetings have all the information on which to base decisions.

12. **Does the charity give sufficient information to new Trustees to enable them to understand the purposes of the charity and its structure?**

There are few charities which would take on new staff without providing them with relevant information.

However in many cases people are invited to become trustees without any real explanation of what is involved.

Incoming trustees should be supplied with all the information they require about the charity and their role in governing it if they are to be effective and if they are to avoid liabilities.

The information that they need would include:-

- A brief history of the charity.
- The governing instrument.
- The roles and responsibilities of the trustees.
- The annual report and accounts for the previous three years.
- A recent set of papers and minutes of trustee meetings.
- The trustees and committee structure.
- The organisation staff structure.
- The terms of reference for the trustees or committees.
- The dates of forthcoming meetings.
- The Chief Executive's job description and the job description of the other senior management.
- The contact details for trustees, the Chief Executive and the senior management.
- Major policy documents.

13. **Do new Trustees know their obligations on accepting appointment?**

A new trustee's initial obligation on accepting appointment is to identify the charity's property for which he has assumed responsibility. The annual audited accounts and any interim

accounts should be carefully reviewed and details of any current investment portfolios and bank balances should also be studied.

Trustees should be made aware of the extent of the charity's property (particularly land and buildings) and of details of mortgages and leases in respect of that property and all insurance policies.

Trustees should know where the deeds and documents relating to the charity's property and securities are kept and who has authority to remove them. It should also be established at this stage whether any of the charity's property is onerous.

14. **Does the charity have an audit committee and does it need one?**

Charities conduct their affairs as a business. Compared to a commercial company there is an added dimension as there is a high degree of public accountability due to their charitable status and the donation of public funds. The need for an audit committee depends on two facts:

- (a) the size and turnover of the charity;
- (b) the vulnerability of its funds.

15. **Are some of the Trustees remunerated and if so does the charity have power to provide remuneration?**

In April, 1994, the Charity Commissioners published the second volume of their decisions.

This included their decisions on the remuneration of charity trustees.

The gist of this is that:-

- (a) The office of trustee contains no automatic entitlement to remuneration.
- (b) The Commissioners will only authorise remuneration of charity trustees in those areas where it can be shown to be both necessary and reasonable.

- (c) The burden of producing the evidence to show that remuneration is both necessary and reasonable lies upon the trustees proposing it and will require the production of cogent evidence.

In the case of new charities a remuneration clause may therefore be acceptable to the Charity Commission provided that it can be justified and that it limits remuneration to a reasonable sum for services undertaken.

In the case of charities already in existence where they have a remuneration clause in the governing document then the trustees could properly receive remuneration but must adhere to the strict terms of the power.

In the case of existing charities where there is no power of remuneration then the trustees are not entitled to receive any remuneration for their services. This is based upon the principle that a trustee can not make a profit from his trust.

Where, however, trustees consider that the payment of remuneration is necessary to ensure the good administration of the charity and reasonable in relation to the service to be rendered to the charity by the trustees and the income of the charity, they can make an application to the Charity Commissioners, seeking an order authorising remuneration.

It should be noted that the term remuneration would also extend to include any profit made by a trustee out of any transaction into which he (or a firm in which he has a financial interest) has entered with the charity.

The Charity Commission has recently undertaken a consultation exercise on the issue of the payment of charity trustees. A majority of those responding to the consultation agreed that charity trustees should not be paid unless there is strong justification for doing so. The Charity Commission has recently issued guidance setting out the factors which charities should take into account when considering the need to remunerate the trustees including factors such as:

- Whether the paid trustees will be in the minority;
- Independent ways of deciding the level of payment; and

- What evidence there is that there is a lack of willing volunteers with the required skills.

16. **What is the extent of the Trustees' responsibility for the health and safety of staff, and visitors?**

Trustees have ultimate responsibility for the health and safety of all the staff of the charity and all those using the charity's premises. Trustees should ensure that competent people are appointed to ensure that health and safety policies complying with the law are devised, implemented and reviewed regularly.

Almost certainly the most frequent cause of concern for most trustees will be their responsibilities for the health, safety and welfare of their staff.

The law governing the health and safety of staff is complex. One reason for this is that it emanates from a variety and combination of sources.

First there is common law which establishes negligence as a tort.

Secondly there is statute law covering, for example, civil liability in respect of premises (occupiers' liability) and criminal liability in respect of unsafe working conditions.

All these areas of the law are of wide application.

To discover the responsibilities of trustees it is necessary to look at relevant legislation and cases.

Those in charge of managing the charity's property have considerable responsibilities for the health and safety of anybody making use of the charity's facilities or entering its buildings or grounds, whether staff or the general public. Not only is there a duty to maintain the premises, equipment and plant so that they are safe and present no hazards to health, but the maintenance itself must be undertaken in a safe manner, as must any new construction work.

Trustees must also consider the various Regulations which have been made under Section 15 of the Health & Safety Act 1974 in response to the directions issued under the Treaty of Rome. Some of these are:-

(1) **The Management of Health and Safety at Work Regulations 1999**

These require a charity to conduct a risk assessment in order that preventative and protective measures can be identified, provide appropriate health surveillance, set up emergency procedures and provide information to employees on health and safety and provide training opportunities for staff.

(2) **The Workplace (Health Safety and Welfare) Regulations 1992 as amended**

Under which a charity is responsible for ensuring that it adheres to the requirements with regard to working environment, safety facilities and housekeeping.

(3) **The Health & Safety Display Screen Equipment Regulations 1992 as amended**

Under which a charity has to assess the display screen equipment workstations and reduce risks discovered and make sure that workstations satisfy minimum requirements.

(4) **Manual Handling Operations Regulations 1992 as amended**

Under which a charity must ensure that its employees must avoid manual handling operations where this is reasonably practicable.

For any hazardous lifting operations which cannot be avoided, there must be a risk assessment.

(5) **The Personal Protective Equipment at Work Regulations 1992 as amended**

Under which a charity must ensure that personal protective equipment is provided to employees who may be exposed to a risk.

Employees must also be given instruction and training on the risk that the personal protective equipment is supposed to avoid or limit.

(6) **The Provision and Use of Work Equipment Regulations 1998 as amended**

Under which a charity must ensure the provision of safe work equipment and its safe use.

Work equipment is widely defined and will extend to such things as overhead equipment, computers, photocopiers and laboratory apparatus, as well as the type of equipment used by a charity's maintenance staff.

17. **If the charity is incorporated, do the Trustees know of the additional risks imposed upon corporations and their directors following cases on corporate manslaughter such as the Lyme Bay case?**

Trustees should be aware of the additional risks imposed upon corporations and their directors following the judgment in December 1994 in the Lyme Bay canoe disaster case.

This case made English legal history on two counts:-

- (1) It was the first time a company had been convicted of manslaughter.
- (2) It was the first time a company director had been given an immediate custodial sentence for a manslaughter conviction arising from the operation of a business.

Where the activities of a charity could give rise to loss of life or injury, trustees should review their activities to consider whether there is any significant risk that the charity's activities could result in death or serious injury and ensure that the charity's conduct does not fall seriously and significantly below that which could reasonably have been demanded of it in preventing a risk from occurring or preventing a risk, once in being, from resulting in the harm.

18. **Are the Trustees aware of the statutory requirements affecting the charity?**

Trustees should be aware of the many statutory requirements affecting their charity and the fact that the breach of these requirements may give rise not only to criminal liability but also,

in some cases, to the possibility of the charity's insurers seeking to avoid liability for the risks which would otherwise be covered.

In view of the importance of ensuring compliance with the relevant statutes, it is suggested that the trustees should call for a review to be carried out to ensure that the charity satisfies all the statutory requirements imposed on it.

Besides the health and safety requirements to which reference has already been made, statutory provisions in the following areas may be amongst the most important to be considered:-

(1) **Fire Precautions Act 1971**

(2) **Occupiers' liability**

A charity has liability under the Occupiers' Liability Act 1957. These rules define an occupier's liability as being those that govern the liability of that occupier for injuries to persons who come on to the premises (i.e. visitors to the premises).

Since the passing of the Occupiers' Liability Act 1957 there are only two classes of visitors - visitors as such and trespassers.

The statutory duty under the Occupiers' Liability Act 1957 applies to visitors only.

The duty owed to the visitor is the common law duty of care. This means the duty to take such care as in all the circumstances of the case is reasonable to see that the visitor will be reasonably safe in using the premises for the purpose for which he is invited or permitted by the charity to be there, including the degree of care to be looked for in the visitor.

The duty owed to a trespasser is imposed by the Occupiers' Liability Act 1984 which provides that the occupier of land has a duty to ensure that all reasonable and practicable steps are taken to warn potential trespassers of any danger which may be present or to exclude them from the property. Where trespassers are or are likely to

be children, the occupier must by means of effective warning or protection keep them from injuring themselves.

(3) **Licensing**

The charity has to comply with all the requirements of the licensing legislation.

The most obvious of these are the requirements to obtain licences for any of the charity premises where liquor is being sold (e.g. at charity functions).

The Charity Commission has recently issued guidance on this subject.

(4) **Food Safety Act 1990 as amended by the Food Standards Act 1999**

The provisions of these Acts apply to any catering conducted by the charity and, therefore, may also need to be reviewed.

19. **Has the charity recently conducted a risk assessment and is it satisfied with the precautions that it takes?**

This is complicated because a risk assessment should cover all the areas where risks could arise. It is difficult to find people who are well qualified to carry out such assessments objectively and it is likely to involve considerable expense.

Nonetheless it is vital and should be repeated at regular intervals.

At the same time all the insurance policies of the charity should be reviewed (in particular their exclusion clauses) to find out in what circumstances the charity is not covered.

20. **Does the charity maintain adequate insurance cover?**

Trustees have a responsibility to ensure that their charity maintains adequate insurance cover.

Trustees should insure to full value all property of the charity (such as land, buildings, furniture and computers).

Trustees are required by law to insure against any liability for personal injury or illness sustained by employees as a result of their employment. All individuals who are employed by the charity must be covered.

They also need to insure for liability to members of the public.

Public liability insurance is needed to provide cover for any injury, illness or damage to property incurred by members of the public as a result of the activities of the charity.

Insurance of charity property and insurance against specific risks is one of the key ways in which charity trustees are able to protect themselves against potential liability.

21. **Does the charity provide insurance cover for its Trustees and if so is this authorised?**

If trustees act prudently, lawfully and in accordance with their governing document then any liabilities they incur as a charity trustee can be met out of the charity's resources provided that the resources are sufficient.

If they do not act prudently, lawfully and in accordance with their governing document then they may be in breach of trust and personally liable to make good any loss to the charity.

As trustees act jointly in administering a charity, all the trustees are jointly liable to make good any loss (subject to the points made in the opening paragraphs above).

The Charity Commission has power to take proceedings to recover from charity trustees personally any funds lost to a charity because of a breach of trust.

As explained above, the trustees of unincorporated charities have additional personal liabilities because they are potentially personally liable in contract since their charities do not have separate legal existence and all contracts are entered into with the trustees.

Protection by insurance

Non-charitable companies generally pay for insurance cover for directors and officers and increasingly this type of insurance is being considered for charity trustees.

Until 1991, the principle that no trustee should profit from his trust prohibited the taking out by a charity of indemnity insurance for its trustees.

It has, however, always been possible for trustees to purchase trustee indemnity insurance at their own cost.

In 1991 the Charity Commissioners gave authority to enable charities for the first time to provide insurance for their trustees against liability for two classes of acts.

The first were acts properly undertaken in the administration of the charity and the second were acts undertaken in breach of trust but under an honest mistake.

The Charity Commission have identified the cover that is not permissible as cover:

"for loss arising from any act or omission which the trustee knew to be a breach of trust or breach of duty or which was committed by the trustee in reckless disregard of whether it was in breach of trust or breach of duty or not".

To avail themselves of this ability to insure, a charity must have power in its constitution to insure its charity trustees. If a charity does not have such a power in its constitution, Charity Commission consent is required to the addition of this power to the charity's constitution.

22. **Does the constitution of the charity include express provisions excepting the Trustees from personal liability from breach of trust?**

The other way of reducing the risk of personal liability is by ensuring that the governing instrument of the charity includes express provisions excepting trustees from personal liability for breach of trust. The Charity Commission accepts such limitation can be provided unless the breach of trust occurs as a result of wilful and individual fraud or wrongdoing or wrongful omission on the part of the trustee as charity trustee.

The expressions "wilful", "wrongdoing", and "wrongful" are imprecise legal terms but do imply a level of blameworthiness far in excess of negligence.

23. **Do the Trustees know what the procedures are for the disposal of land owned by the charity?**

Under Section 29 of the Charities Act 1960 the trustees of non-exempt charities, with certain exceptions, were not allowed to sell, mortgage or otherwise dispose of the charity's land without an order of the Court or of the Charity Commission.

The Charities Act 1992 repealed Section 29 and substituted new procedures for disposals of charity land.

These new procedures have been re-enacted in the Charities Act 1993.

An order of the Commissioners will now be required only in those cases where for any reason trustees are unable to follow the new procedures.

The new regime operates as follows:-

- All dispositions of land in favour of a charity must contain a statement as to whether the charity is exempt or non-exempt and, if the latter, as to the restrictions on dispositions imposed by the Charities Act 1993.
- Dispositions of land by a charity must contain a similar statement.

The term "dispositions of land" includes the sale and mortgage of land.

In the case of a non-exempt charity the disposition must also contain a certificate by the charity trustees stating either that the transfer or charge has been sanctioned by an order of the Court or the Charity Commissioners or that the charity trustees have power under the trusts of the charity to effect the transfer or charge and that they have complied with the provisions of Section 36 of the Charities Act 1993 (as far as a transfer is concerned) or Section 38 of the Charities Act 1993 (as far as a charge is concerned).

As far as the provisions for a disposal of charity land are concerned, the Charities Act 1993 requires a charity wishing to sell or lease any land or buildings to obtain and consider a report from a qualified surveyor who must act exclusively for the charity.

The sale must be advertised as advised by the surveyor and any agreement concluded on terms that are the best that could reasonably be obtained.

The surveyor's report must be in writing if the disposal is a sale or a lease for more than seven years.

If the property or land sold or leased is subject to trusts requiring it to be used for specific purposes for the charity, the charity needs specific power to sell the property before it is put on the market.

The charity must then advertise what it is planning to do to give the public the opportunity to raise objections.

If unable to follow this procedure or if the charity wishes to sell the land to a person connected with the trustees, the charity must seek the consent of the Charity Commission.

Before a charity raises a mortgage on its property, it must obtain written advice from someone experienced in financial matters who has no personal interest in the proposed loan and that person must advise on the need for a change, its terms and the charity's ability to repay on those terms.

The latter point is frequently breached by charities which seek facilities from their banks covered by a pledge of the charity's property.

24. **Do the Trustees know where the deeds/documents of title to the charity's property are held and who has authority to remove them? Do they know in whom any land the charity owns is vested?**

In the case of an unincorporated charity it is important to ensure that the title deeds are registered or vested in the names of the current trustees. This is often overlooked.

It is often helpful for charity assets to be held through a nominee company. Most charity governing documents will contain an express power allowing use of nominees. Failing that,

the Trustee Act 2000 contains default statutory powers allowing the use of nominees in a trust situation.

25. **Have the Trustees studied the latest accounts of the charity, do they understand them and have they considered all the matters raised in any management letter from the auditors?**
26. **Do the Trustees know what the general effect is of the new accounting procedures for charities?**

Under Charities Act 1993 all charities are required to keep accounting records of all their transactions and to prepare annual accounts of the assets and liabilities of the charity and of its activities since the previous accounts. The size and income levels of a charity determine the type of accounts which need to be produced and the audit requirements.

Regulations have been issued by the Home Office with the definitive Statement of Recommended Practice (SORP), the latest version of which (SORP 2000) has recently been released. The charities SORP came fully into effect on 1st January, 2001 and accounts for financial periods starting on or after that date will need to comply with it.

All registered charities must submit their annual report and accounts to the Charity Commission.

Members of the public have a right to inspect the annual report and accounts and for a reasonable fee can request a copy of the accounts directly from the trustees.

Charitable companies are subject to the Companies Act 1985 (as amended) which requires all registered companies to file a copy of the audited accounts with the Registrar of Companies.

A charity with a gross income in excess of £250,000 is required to include a statement (as part of its accounts) as to whether the charity trustees have given consideration to (i) the major risks to which the charity is exposed and (ii) systems designed to mitigate those risks.

Financial governance by charity trustees is vital if they are not to be held accountable for loss caused through misappropriation of funds. Some of the crucial questions relating to this area are as follows:

27. **Who has authority to sign cheques on behalf of the charity?**
28. **What are the limits of authority as to the amounts authorised to the people who sign cheques?**
29. **Do the Trustees know if there are overall limits beyond which Trustee authority must be given to effect payments?**
30. **Does the charity's bank know these limitations?**
31. **What arrangements are made for controlling the receipt and banking of money?**
32. **If the charity has large sums of money to keep on deposit is there a written policy about the places where it may be deposited? If so what arrangements are there for ensuring that the policy is adhered to and reviewed periodically?**

Charity trustees' compliance with their investment duties is also critical:

33. **What is the extent of the Trustees' powers of investment?**
34. **What criteria must the Trustees take into account in making investment decisions?**

Until very recently the Trustee Investments Act 1961 set out the framework for the powers of charity trustees to invest. It provided the trustees with basic investment powers but did not prevent a charity's governing instrument from conferring wider powers upon trustees. Modern charities commonly include such powers and most modern constitutions allow charity trustees to invest in any investments in which they think fit.

The statutory investment powers of trustees have been changed by the Trustee Act 2000. This Act provides that charity trustees (and indeed all trustees) have wide powers of investment giving them the same powers to invest as if they were beneficial owners of the assets. This wide power of investment is limited if there are specific restrictions on investment contained in the charity's constitution.

However, section 4 of the Trustee Act 2000 requires trustees to have regard to the following investment criteria :

- "(a) the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind; and
- (b) the need for diversification of investments of the trust in so far as is appropriate to the circumstances of the trust."

In addition to these statutory duties, case law imposes a general duty of care on all trustees including charity trustees.

The main requirement is that trustees should avoid investments of a hazardous or speculative nature.

This applies even where the trustees have the investment powers of an absolute beneficial owner.

35. **Does the charity invest in derivatives/traded options and if so is that authorised?**

There are particular areas where the Charity Commission has warned charity trustees against speculation and these are "investments" in derivatives/traded options and the underwriting of new share issues.

The Charity Commission has said that the borderline between what constitutes an investment and what constitutes speculation is narrow but that a distinction can be drawn between investments in stocks and shares on the one hand and speculation in fast wasting assets such as traded options on the other.

They say that, except where specifically authorised, the purchase of options is not permissible by charity trustees.

36. **Does the charity underwrite new share issues and if so is that authorised?**

As far as underwriting is concerned, the Commission has said that except where a charity is a substantial institutional investor where it is necessary and desirable for it to underwrite in order to obtain a significant allotment of new shares it is otherwise too speculative for a charity to underwrite share issues unless the power to do so is specifically authorised by the charity's governing instrument.

37. **Does the charity adopt an ethical investment policy and if so is that authorised?**

The decision of **Cowan v. Scargill** in 1984 laid down the duty of trustees of a pension fund (not a charity) to obtain the best possible financial return and also dealt with their power to invest ethically. The Court in that case effectively put forward the proposition that trustees have a duty not to fetter their investment decisions for reasons extraneous to the trust purposes including reasons of a political or moral nature or matter of conscience.

This gave rise to questions relating to ethical investments by charity trustees.

The Charity Commission has said that while the normal duty of charity trustees exercising their investment powers is to provide the greatest financial benefits, financial return is not in all cases the sole consideration which the trustees should bear in mind.

They say that the charity trustees should not make an investment directly contrary or inimical to the charity's trust or powers.

38. **Does the charity delegate its investment powers and if so is that authorised?**

As a matter of general principle, charity trustees must act personally performing their tasks.

However, there are certain circumstances in which delegation is permitted and the Charity Commission has set out the circumstances in which charity trustees can delegate investment management.

These are as follows:-

- (a) Where a trustee has an existing management agreement which is sanctioned by an express power of delegation in its governing instrument, no problem arises.

- (b) Where a charity has such an agreement but no power in its governing instrument, an order of the Charity Commission is needed to allow the agreement to continue.
- (c) Where a charity has neither an existing management agreement nor the constitutional power for such delegation but the trustees wish to enter into an agreement, the trustees will have to apply to the Charity Commission for an order permitting them to do so.

However, now that the Trustee Act 2000 has come into force, charity trustees of charitable trusts have an extended statutory power to employ agents and delegate investment management powers.

- 39. **If the management is delegated is there a written investment policy which has been given to the investment managers and if so what arrangements are there for ensuring that the policy is adhered to and reviewed periodically? Has the charity entered into a formal investment management agreement?**
- 40. **What arrangements are there for ensuring that the performance of the investment manager is reviewed periodically?**
- 41. **Does the charity conduct a trade directly and if so is the trade entirely in pursuance of its primary purpose?**
- 42. **Does the charity conduct a trade and, if so, if the trade is not in pursuance of its primary purpose does the charity conduct its trade through a non-charitable subsidiary?**

A charity is exempt from tax on its investment income and also on trading income earned in pursuance of its objectives (its primary purpose) or where the trade is carried on by beneficiaries of the charity.

The Finance Act 2000 (section 46) makes provision for small amounts of trading income to be exempt from tax even if the trade being carried out is not a primary purpose trade.

The limit is the greater of:

- (a) £5,000; and
- (b) whichever is the lesser of £50,000 and 25% of the charity's incoming resources for the chargeable period.

However, if a charity carries out a significant non-primary purpose trade there could be loss of tax relief on trading income.

In this situation the charity should set up a non-charitable trading subsidiary which will carry out the trade. Each year the trading company can gift aid its profits up to its parent company leaving no profits to be taxed in the subsidiary. In this way the trading income can be passed up to the charity without suffering tax.

43. **If the charity owns a non-charitable trading company is that trading company adequately capitalised and have the Charity Commissioners and the Inland Revenue given approval to the capitalisation?**

Many charities will set up non-charitable trading companies to conduct non-primary purpose trading activities.

Trading through such companies has a number of benefits.

As mentioned above, it is possible to arrange matters so that all the profits can be transferred to the parent charity in a tax efficient manner.

It also ensures that the trading subsidiary will be a separate entity with limited liability.

However problems normally arise in relation to the provision of the working capital required for the trading company.

This working capital is normally provided by the charity and trustees have to consider two questions in relation to this provision of working capital and these are:-

- (1) Does the charity have the investment powers necessary to make such an investment?

(2) Have they obtained Inland Revenue approval to the investment?

As far as the Inland Revenue approval is concerned this is required because an investment in a trading company is an investment which is not included in the list of qualifying investments and qualifying loans that can be made by charities without incurring tax charges (section 506 of and Schedule 20 to the Income and Corporation Taxes Act 1988).

There is however a provision that a charity can apply to the Inland Revenue for approval to make such loans or investments (Schedule 20, paragraph 9).

Both the Inland Revenue and the Charity Commissioners expect that transactions with a trading subsidiary should be on an arm's length basis.

The investment therefore will have to stand up to commercial scrutiny.

This will be tested in the case of a loan by the rate of interest payable, the terms of repayment and security.

Any transaction between the charity and the subsidiary will have to be at arm's length and no extended credit can be provided.

Trustees must also consider the position of the trading company if all the profits are extracted each year as this may lead the trading company into a position whereby it will technically become insolvent at the end of each year.

44. **If the charity disposed of its trading company would it cover its entire investment?**

This really follows on from the preceding question because trustees have to justify the investment they make in a trading company and they should be satisfied before making the investment that it is likely to be successful and therefore in the interests of the charity.

45. **Are any loans by the charity to the subsidiary fully secured and made at a market rate of interest?**

46. **If the charity conducts fundraising are the Trustees aware of the fundraising regulations that apply?**

Charity trustees may decide to raise funds by employing a professional fundraiser, or by entering into a promotion with a commercial participator. If so, they need to be aware of the provisions of Part II of the Charities Act 1992 and The Charitable Institutions (Fundraising) Regulations 1994 which includes requirements for:

- a written agreement, in a prescribed form between the charity and the professional fundraiser or the commercial participator;
- a clear statement to be given to inform potential donors what proportion of their donation will be used to pay the costs of the fundraiser;
- the public to be informed how the charity will benefit from its involvement with a commercial participator; and
- transfer of funds raised by professional fundraiser or commercial participator to the charity.

47. **If the charity conducts political activities does it follow the Charity Commissioner's guidelines?**

Many people believe that charities are forbidden to take part of any form of political activity. This is not the case. In 1991 the Charity Commission said:-

"It is not the intention of the law nor the business of the Courts and the Charity Commission to stanch the contribution of charities to public life. Charities operate for the public benefit. Charity trustees may bring their experience to bear where it is relevant to reflect the interests of their beneficiaries wherever those interests may be affected. The nation would be impoverished if charities were to be cut from public debate and the opportunity to inform decision-makers. They have a wealth of knowledge and experience to bring to bear on the solution of problems and not solely on their treatment."

A charity may undertake policy work and political activity when it comes up against a problem affecting the people or the cause it exists to promote.

Charities may within limits use political means to achieve their charitable purposes.

However charities must avoid propaganda and must be able to demonstrate that their arguments are reasoned and that they present a case based on their experience.

The Charity Commission have issued guidelines which set out in considerable detail those activities which charities can undertake and those activities which charities must not seek to undertake.

Charities must not raise issues which do not relate directly to their charitable objects.

Charities must avoid party political activities.

If the Charity Commission finds that charity trustees have carried out political activities that are not permissible then they can require the charity trustees to repay to the charity the value of any funds spent on those activities.

48. **Do the staff of the charity have proper contracts of employment?**

Trustees will need to ensure that they abide by current employment legislation.

In particular all employees must have a contract of employment once an offer is made and accepted.

49. **Does the charity own any onerous property and, if so, do the Trustees understand the nature and extent of the liabilities attaching to it?**

Trustees need to be aware of any onerous property that is owned by the charity.

Examples of onerous properties are listed buildings and leases.

Trustees must decide whether the charity has sufficient assets to meet the obligations in respect of such property.

These points are of special concern to trustees of an unincorporated charity.

50. **Do the Trustees have up-to-date financial information for the charity and if there is any doubt about the charity's solvency can they be certain that it will satisfy the balance sheet test?**

If trustees think their charity may be in difficulty they should apply the simple balance sheet test for insolvency (i.e. can the charity meet all its liabilities including the expenses of winding up out of its assets).

A crucial point to bear in mind is that the fixed assets are not generally available to provide short term finance. The figures shown in the balance sheet do not give any indication of what might be obtained from the assets on a forced sale because it is assumed that the charity will continue. Therefore if the trustees think that their charity is facing insolvency they need to value the charity's total assets at what they could get for them if they had to convert them into cash quickly.

The distinction between restricted and unrestricted funds is crucial. Restricted funds are those subject to specific conditions imposed by the donor and binding on the trustees. The condition may be stated expressly by the donor or implied as a result of money spent in response to a specific appeal. These funds represent unspent income or assets, the use of which is restricted and which would not generally be available to pay the debts of the charity.

If provisions are included in the accounts (e.g. in respect of obligations under leases) it is imperative the trustees determine whether these are realistic.

Account should always be taken of potential redundancy claims if a charity had to be wound up, the obligation in terms of premises (e.g. repairing obligations when a lease comes to an end) and leases of equipment such as photocopier rental agreements.

The insolvency of a non-incorporated charity can lead to bankruptcy of the trustees since the trustees are personally responsible for all the debts of the charity. It should be noted that creditors can sue any one of the trustees of a non-incorporated charity.

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RISKS OF BEING A CHARITY TRUSTEE
HOW NOT TO FALL FOR THE PITFALLS

Lecture given by
Jennifer Chambers
26th September, 2001

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