

The responsibility for a charity or voluntary organisation ultimately rests with its board of trustees. Therefore, it is vital that board members understand the nature of this responsibility and the liabilities involved.

**Reducing the Risks** is produced by the Governance Hub and provides invaluable guidance on assessing and minimising the risks associated with trustee liabilities.

**The Governance Hub** exists to improve governance within the voluntary and community sector in England by:

- increasing the supply of trustees
- enhancing trustee learning and development
- strengthening and extending support services for trustees.

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# Reducing the Risks

## A Guide to Trustee Liabilities

The Governance Hub is a partnership of eight organisations that provide support to the voluntary and community sector: Association of Chief Executives of Voluntary Organisations (ACEVO), the Black Training and Enterprise Group (BTEG), The British Association of Settlements and Social Action Centres (BASSAC), Charity Trustee Networks (CTN), East Cornwall Council for Voluntary Services (ECCVS), the National Association for Voluntary and Community Action (NACVA), the National Council for Voluntary Organisations (NCVO) and Volunteering England.

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# Reducing the Risks

## A Guide to Trustee Liabilities

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## Section 1 Defining trustees and their liabilities

### Introduction

We are all concerned about managing risk in whatever activities that we undertake. It is important that people who give their time to run charities and similar organisations are aware of, and feel comfortable with, those limited risks involved with this type of role.

This guidance looks at the **risks** that might affect charity trustees. It is *not* an attempt to look at the full range of risks affecting organisations that they govern. If an organisation does not have limited liability, the risks that affect the organisation may become risks for the trustees. This happens where the organisation has not got the funds to effectively protect the trustee.

This guidance is brief and deals with a complex area. Where possible, we have included helpful examples, preventative advice and also explained jargon (see Appendix 1). The guidance also provides signposting to further sources of information.

### ***The reality of risk***




The job of this guidance is to point out the nature of risk for trustees. As such, of necessity, it dwells on the less attractive side of being a trustee. The reality is that this country has more than 200,000 registered charities and many more voluntary and community organisations, and its courts are not filled with trustees facing claims.

The regulator for the sector, the Charity Commission, does not seek to punish trustees except in the most serious cases of fault or neglect. Most people within the sector would be hard put to name



a single situation in which a trustee had actually suffered personal loss or liability. They would be less hard put to name situations where they knew trustees had been anxious about the outcome of various activities. However, it is one of the facts of life that all who seek to achieve something worthwhile will occasionally face worries and difficulties.

This resource uses the following easy-to-read symbols to help signpost further information and recommendations for preventing problems:

	<b>Further Information</b>
	<b>Preventing the Problem</b>
	<b>Case Study</b>

## 1. What is personal liability?

**Trustee liability** may arise because trustees:

- are responsible for the criminal offences of the organisation
- are responsible for some breaches of statutory duty, for example, in health and safety
- are liable under covenants, obligations or mortgages affecting land or other property
- have to repay money because of trust obligations, for example, if they made a personal profit from a contract or because they had breached trust duties, such as having spent the organisation's money on activities outside its objects
- have broken contractual obligations, for example, the organisation cannot meet the final payment on a building contract or have delivered faulty services

- have committed a wrongdoing (called a tort) or authorised others to do this. For example, they have published an untruth about someone.

Liabilities fall into two categories:

- **operational liabilities:** arising from *what the organisation does*. Example: where the trustee signs a lease for the organisation that fails to pay the rent.
- **governance liabilities:** arising from *the duties that a trustee has*. Example: where a trustee had entered into a contract with an organisation that benefited him and he had to repay the improperly obtained profit.

## 2. Who is a charity trustee?

This advice is for charity trustees who have the responsibility for governing or running a charity. The technical definition of a charity trustee is:

‘The persons having the general control and management of the administration of the charity.’ (*Charities Act 1993*, Section 97)

Trustees are defined by what they do, not how they are labelled. Confusingly, they are called by many different names, including:

- management committee members
- council members
- governors
- board members
- executive committee members
- directors.

What they all have in common is that they are the final arbiters of what their organisation does (even if they may not sometimes feel they are).



There are a number of types of trustee. For a more detailed explanation see Appendix 1, Jargon and Definitions.

### **Identifying trustees**

It is vital to correctly identify who the trustees are in your organisation. This is not always easy. Some charities have fairly complex governance structures that might involve a small 'executive committee', a 'board of management' and a wider representative body sometimes known as the 'national council'.

In a three-layer structure like this, you need to be really clear about who the trustees are. For instance, if the board of management delegates powers to the executive committee who do a lot but are actually finally answerable to the board, then the board members will be the trustees. If the national council has the final say on everything, but delegates implementation to the board, then council members will be the trustees.



### **Preventing the problem**

After looking at your constitution, you may feel you need to spell out more clearly who has trustee responsibility, or take advice on this issue.



There are various routes to becoming a trustee without being appointed, the most common of which is a shadow trustee. See Appendix 1 for details.

### **Are you really a trustee?**

You may sit on a committee running an organisation and be addressed as a trustee but were you properly appointed? A surprising number of charities do not understand the election

or appointment process that puts people on their governing body. Your first job when you join the governing body is to check that the way you join the board or committee actually is a valid method of appointment.

Examples of things that go wrong:

- You were elected at the annual general meeting but no-one checked that the people who voted were properly members of the charity
- You were elected properly by voting members but the constitution says that you had to go through some procedure, for example, a nomination procedure before you could stand
- You were elected properly but there is a fixed term of office, it has expired and you have not been properly re-elected
- You were properly re-elected but your constitution specifies a maximum number of terms of office that you can stand without a break.



### **Preventing the problem**

Do not be fobbed off by being told that the elections have always been conducted that way. Make sure that the paper work and the reality correspond.

### **Who cannot be a trustee?**

#### **Young trustees**

If the charity is in the form of a company, someone under the age of 18 may serve as a director. For unincorporated bodies and trusts, the trustees must be over 18.

## Disqualified trustees

Under the Charities Act and the Companies Act, a person is disqualified from acting as a charity trustee if they:

- have a conviction for an offence of dishonesty or deception, unless the conviction has been ‘spent’ under the terms of the Rehabilitation of Offenders Act 1974
- are bankrupt or have had assets sequestered unless it has been discharged or permission has been granted under the Disqualification Act 1986
- have financial problems meaning they have made a composition or arrangement with creditors under the Insolvency Act 1986 and this has not been discharged
- have been removed by the Charity Commission, High Court or the Court of Sessions in Scotland from being involved in the management of, or acting as a trustee of, a charitable body
- have been disqualified under the Company Directors Disqualification Act
- are subject to an order under the Insolvency Act 1986 for failure to make a payment under a court order.

A disqualified person can apply to the Charity Commission to waive the disqualification. It is a very serious offence to serve without such waiver, punishable by a fine or up to two years’ imprisonment (*Charities Act 1993, Section 73*). The Commission can require the repayment of any payments received or expenses received while serving as a disqualified trustee.



### Preventing the problem

Ensure that your procedures bring this issue to the notice of all prospective trustees by asking them to sign a document that explains clearly the grounds for disqualification and the consequences of acting if disqualified.

## Other exclusions

### Observers and others ‘in attendance’

Other people may attend meetings of trustees and even take part in the discussion. Provided they do not have authority to make decisions, for example they do not take part in the voting, they will not have the responsibilities of trustees. They are often called ‘observers’.



### Preventing the problem

It is good practice to make sure that minutes of any meeting of trustees make clear who is there as a trustee and who is in attendance or observing.

## Summary

Who is and who is not a trustee is not always clear. Language can be deceptive and there are widespread misconceptions as to who has the responsibilities of a charity trustee.

Quite often you hear people saying, “I don’t mind being on the management committee, but I don’t want to be a trustee”. Such a statement has no effect. If you are on the management committee and that committee is the charity’s governing body - making decisions directing the course of an organisation - then you will be one of its trustees, whether you accept the title or not. With the role will come duties, responsibilities and liabilities.

Where a charity is a company, occasionally people say, “I will go on the governing board and I don’t mind being a charity trustee, but I don’t want to be a company director”. This too will have no effect since if you are sitting on that board making those decisions, you will be a director, albeit perhaps a de facto director.



See Appendix I for more information about de facto trustees.

### 3. Where do liabilities come from?

As explained earlier in this section, liabilities for trustees can be grouped into two categories:

- **governance liabilities** which arise because of the nature of the trustee job. The most common of these liabilities arise from their obligations as charity trustees or as company directors. They are inherent in the role. For example, the trustees' duty not to profit improperly (e.g. from buying an undervalued property from the charity or selling its services) means that a trustee who makes such a profit must pay it back to the charity
- **operational liabilities** arising from the activities or constitution of the organisation. An example is liability for rent under a lease or because of an injury caused to a staff member. There are a number of circumstances when the organisation's operational liabilities can create personal liability for trustees if that organisation has not incorporated (see 3.1 Incorporation). Where the organisation has not incorporated, the trustees are in effect the organisation. This means all liabilities of the organisation are ultimately theirs. Normally they will not be liable because the charity will do whatever is required or meet the obligation. But if the charity does not pay a debt or some other liability or does not have the funds to indemnify the charity trustee, the trustee could be liable.

#### 3.1 Incorporation

Charities can become incorporated in a number of ways. These include:

- a company limited by guarantee
- an industrial and provident society – often called a ben com
- by royal charter
- by statute.

Charities should also soon be able to incorporate under the new *Charities Act 2006* as a Charitable Incorporated Organisation (CIO).

#### What does incorporation involve?

Incorporation means that the organisation has registered through:

- Companies House with the Registrar in the case of companies
- with the Financial Services Authority in the case of industrial and provident societies
- its royal charter or act.

Once registered, the organisation becomes a 'corporate person'. Trustees are then simply the means by which that corporate person makes decisions. It is not the trustee that does the act or takes on the liability, but the organisation. If things go wrong, it is the organisation against which the claim lies in most circumstances, even if the trustee signed the lease or other document creating the liability.

## What are the pros and cons of incorporation?

Advantages	Disadvantages
Limited liability for the trustees	More complex documentation
Limited liability for the members	Obligation to comply with rules regarding registration and remaining registered
Permanent existence for the organisation	Potential costs of set up and winding up
Legal personality e.g. it has the ability to hold property in the name of the organisation rather than through trustees	

You should choose to incorporate if your organisation is:

- likely to exist for a considerable period of time
- involved in areas which create risks, for example, signing leases and taking on staff
- has the administrative capacity to comply with the registration requirements.



### Case study

If a person thinks they have got a claim against a charity and it is incorporated, that person's lawyer delivers the legal claim to the registered office of the charity. If it is an unincorporated charity, whether an association or trust, those court documents will have to be delivered to the individual trustees. It may well be that the unincorporated charity has a good defence and indeed more than enough money to meet any claim, but such direct personal involvement in court proceedings can be upsetting.



### Preventing the problem

Gain a real understanding of your constitution and whether it sufficiently protects you. Also read Charity Commission Guidance CC22 *Choosing and Preparing a Governing Document*.

## 3.2 Risks not covered by incorporation

### Statutory penalties and prosecutions

Even if you are incorporated, there are some pieces of law under which a trustee may still be liable if they have contravened the law, e.g. health and safety.

### Authorised wrongs

If a trustee directly authorises a wrong, for example, libels someone, agrees for a libel to be published or instructs someone to act in a way that leads to loss being caused by trespass, then a trustee as well as the organisation may also be liable.

## Duties of company directors

Company directors have a series of duties very similar to those of trustees. Like trustee duties, these are duties that come because you are director of an incorporated body and can be enforced against you personally. These can be summarised as:

- a duty to act within the powers of the governing document
- a duty to promote the success of the company but have regard to other factors such as the consequences for employees
- a duty to exercise independent judgement
- a duty to exercise reasonable care, skill and diligence – this means not just being careful, but using the general knowledge, skill and experience that would be reasonably expected of someone carrying out your functions as well as any special skills or knowledge that you had
- a duty to avoid conflicts of interest
- a duty not to accept benefits from third parties by reason of being a director and doing or not doing something
- a duty to declare an interest in any proposed transaction or arrangements.

## Duties under the Companies Act

You get the protection of limited liability through registration. Registration requires you to undertake a number of steps such as filing annual returns, keeping proper registers of who is a director or company secretary. If you fail in these duties, you may be fined or in extreme cases imprisoned.

## Duties in solvency

An incorporated body gives limited liability but you must not misuse that protection. The main circumstance of misuse is continuing to trade when the organisation is or will inevitably become insolvent. Once an incorporated body becomes insolvent, the duties of its trustees are to ensure that creditors are protected and that no steps are taken which would prejudice creditors or increase their losses. This will generally involve winding up the organisation.

*Wrongful trading* is the offence of carrying on running the operation and incurring debts once it becomes clear or should have become clear to a reasonable person that there is no prospect of the organisation being able to meet those obligations.

*Fraudulent preference* means, when insolvent, paying off one group who you favour in full and leaving other creditors unpaid.



### Preventing the problem

The key to avoiding these liabilities is to monitor finances. Remember that audit is a review of what happened in the past; insolvency is a risk in the future. Good budgeting, cash flow projections and monitoring are key to understanding your solvency.

Trustees should:

- ensure that they receive regular, up-to-date financial reports
- always ensure that they understand the financial position
- take advice if there are any issues that are not clear to them
- if they think insolvency may be a risk, take advice from their solicitor or accountant.

## Section 2 Understanding trustee liabilities

Liabilities arise out of the duties the trustee takes on for the organisation of which he or she is a trustee. These are personal obligations which come with being a trustee. By accepting the 'job' of trustee, you agree to do the 'job' properly. Rules set out the minimum that must be done to 'do the job properly'. If you fall below that minimum, the charity itself, the Charity Commission or the courts may take action which may result in personal liability. Such action is in fact very rare. Liability generally only arises if the failure to discharge duties actually causes loss to the charity or improper gain to the trustee.

### I. Trustee duties

The key trustee duties are set out below.

#### ***Managing conflicts of interest***

A trustee must act with integrity. This means:

- disclosing any conflict of interest to the organisation
- where the conflict is significant, avoiding being involved in any decision relating to that conflict
- where a conflict is substantial, removing the source of the conflict by giving up the potential benefit or other source of conflict or by resigning as a trustee. Resigning however does not end all your duties.

You cannot take advantage of information or anything else you gained as a trustee. You cannot resign as a trustee and then take a job with the charity unless you get Commission consent.



#### **Case study**

A trustee is also a local councillor and votes on the level of fees the charity will get for a service to be provided to his local authority.

#### ***Personal benefit***

You cannot accept or direct any benefit from being a trustee unless authorised by the governing document or an order of the Charity Commission. Repayment of expenses actually and reasonably incurred is always allowed. But you need to be absolutely sure that it is authorised before receiving anything beyond that.

The obligation not to receive direct or indirect benefits of any sort is broad. It covers financial or personal or some other advantage or gain, including creating a benefit through any connected third party, for instance a spouse, partner or business partner or organisation in which you have an interest.

In particular, there are problems where individuals are involved in:

- payment for work or a service or goods supplied but at a lower rate than they would have normally expected
- honorariums or payments labelled in some non-standard way
- payments to a spouse of the trustee or someone else with whom the trustee shares a common purse
- indirect payments e.g. charity A releases its employee to do work as a trustee for charity B. In return charity B gives a grant or other form of reimbursement to charity A
- a reward to a hard-working treasurer with a grant or other form of reimbursement

- a reward to a trustee of a paid position as director of the charity's trading subsidiary
- the appointment to the job of chief executive of a long-standing trustee of the same organisation.

Reimbursement of out of pocket expenses and trustee costs related to activities such as away days and training are not trustee benefits.



### Preventing the problem

- If any sort of payment other than reimbursement of directly incurred expenditure on the basis of receipts is made, seek advice and read Charity Commission guidance CCI1 *Payment of Trustees*.
- One difficult area is where the beneficiaries themselves are trustees. For example, if you are a trustee of a village hall trust, you are also likely to be a user of that building. The Charity Commission's C224 *Users on the Board: Beneficiaries who Become Trustees* provides useful guidance.

### Following the governing document

The governing document sets out:

- objects which must be kept within
- powers which cannot be exceeded
- restrictions and directions that must be followed.

### Objects

The funds must be applied for the 'objects' of the charity and each trustee must understand what these are. The charity is not there to do 'good things'; it is there for some particular and limited purpose.



### Case study

A charity 'to advance the education of those with learning difficulties in Surrey' cannot educate someone from Sussex, nor can it educate young people in Surrey with physical disabilities who do not also have learning difficulties. If a trustee authorised the charity to do so, there would be liability for authorising the organisation to do something that its governing document did not allow it to do.



### Preventing the problem

If the governing document has inappropriate restrictions, a trustee ought to put in hand the steps necessary to amend those objects. This would normally require Charity Commission consent.

### Powers

An organisation can only do what its constitution authorises it to do or which it is authorised by statute to do. Do not assume that the organisation can do anything that seems sensible to achieve its objects. One of your duties as a trustee is to know what the organisation can and cannot do.



### Case study

You join the committee of a local unincorporated charity committed to improving childcare which has just won a large grant and decide to take a lease of a property to run a nursery. It turns out that your constitution gives no power to take a lease and you could become personally liable for the rent and repairing obligations.



### Preventing the problem

Make sure you understand what your objects or powers allow you to do. If you have any doubts about what it says, seek professional advice.

### Safeguarding assets

This means ensuring that:

- money is not lost
- money is invested prudently
- you do not refuse money or property
- you do not give money away just because you think it was a nice idea if it does not actually advance the purposes of the charity. This is called making ex gratia payments.



See Charity Commission guidance *CC7 Ex Gratia Payments by Charities* for more information.



### Case study

You receive a large grant fund project over a three-year period and invest it. No-one on your board is an expert on investment matters. You agree to an investment in a mobile phone company that the chair tells you will make a lot of money. The share price of that company slumps. You will be liable because you did not exercise sufficient care in selecting the investment. If you did not have the expertise to judge the risks involved yourself, you should have taken professional advice.



### Preventing the problem

A regular review of the possible ways in which you might lose money will highlight the need to take appropriate action.

This might include:

- maintaining a register of assets
- checking that there was adequate insurance cover
- organising a regular review of investments with professional advice.

### Acting prudently

This involves ensuring that:

- the organisation remains solvent
- assets and funds are used wisely
- no activities are undertaken which might place the charity's assets or reputation at undue risk.



### Case study

You are approached by a commercial company collecting second-hand goods door-to-door and promised regular donations if you endorse their service. You do not take up references and the contract you sign without advice gives you no way of monitoring the value of the donations you receive compared with the goods collected by the company. You find out later that they employ workers at less than minimum wage and they never repay the initial loan that they asked for in order to set up the collecting operation.

Prudence is generally about being sensible but it also means recognising that it is for you, not anyone else, to think through the implications of issues facing your organisation.

### **Acting with care**

In particular areas, such as investing by unincorporated bodies, the trustee has a statutorily defined duty to act with due care (*Trustee Act 2000*, Sections 3-5). This involves not only using such care as is reasonable in the circumstances, but also any knowledge or skill the trustees have or hold themselves out as having. This would mean that if trustees were deciding how to invest a large legacy, they would need to select appropriate advisers and follow advice.

### **Acting collectively**

Trustees must act as a group. Individual trustees, even if they are the chair or officers, have no powers unless these are delegated to them. Generally trustees can only delegate where there is clear power to do so in the governing document. Certain forms of delegation may in addition be permitted by the members of a membership organisation, by the Charity Commission or specific Acts. For example, the *Trustee Act 2000* allows trustees of unincorporated bodies to appoint nominees and custodians to hold properties and to appoint and delegate agents to exercise functions.

There are detailed rules and advice should be taken before delegating to nominees, custodians or agents. Where trustees comply with their duty of care, losses arising from the work of agents, nominees or custodians appointed under the *Trustee Act*, will not be laid at the door of the trustees (*Trustee Act 2000*, Sections 1 and 22). Trustees of trusts and charitable associations have a statutory right to delegate powers using a formal power of attorney (*Trustee Act 1925*, Section 25 and *Trustee Delegation Act 1999*, Section 5).



#### **Case study**

You are appointed chair of your local community centre and discover information that seems to indicate that the finance worker has been stealing from the organisation. You dismiss the finance worker for gross misconduct but he successfully alleges that you did not follow a fair procedure. The rest of the committee require you to pay the compensation awarded because they never gave you the delegated power to dismiss. They say that you should have called a full meeting of trustees to authorise any action before you took it.



#### **Preventing the problem**

You may well need delegation arrangements. Make sure they are adequate to deal with emergency situations, clearly set out in writing and authorised appropriately.

### **Ensuring restrictions on funds are observed**

Charities often receive monies for specific purposes, for example, a grant to repair the roof. This means they constitute restricted funds and can only be used for those purposes. A trustee might become personally liable if they authorise, without the funder's consent, the use of a restricted fund for some other purpose.



#### **Preventing the problem**

Trustees must be satisfied that there are effective procedures for ensuring that restricted funds only get spent on the correct purpose and that this can be documented.

## 2. Liability for breaches of trustee duties

So what do these duties mean in terms of liability? Consider the following examples:



### Case study

The chair of trustees authorises the purchase of a van for the charity from a garage company that his wife has inherited shares in. The garage gives the charity a discount, but nevertheless, substantial sums go to the company. This is a breach of duty, not a benefit, and the trustee could be asked to repay the profit made.

The trustees become disaffected with their roles and take to meeting just once a year delegating the day to day running of the charity to staff who in fact misuse its assets. This is a breach of duty to safeguard the assets. The trustees might be required to fund the replacement of those assets.

The key characteristic of these acts is that the charity has suffered loss which would not have occurred if the trustees had not failed in a duty that a normal level of prudence and care would have avoided.

### Who enforces liability?

Breach of these trustee duties could be enforced:

- by the Charity Commission or court – for example ordering the return of income received by an employed trustee
- by the charity itself, for example to recover money lost by an imprudent investment authorised by a trustee
- by the criminal courts, for example a prosecution for misuse of funds.



The Charity Commission emphasises that it is only likely to enforce personal liability where a trustee has acted dishonestly or recklessly. The Commission has produced a number of helpful documents summarising what these duties are, the most relevant ones being CC3 *The Essential Trustee* and CC60 *Hallmarks of an Effective Charity*. These highlight that the duty is personal and while trustees may delegate to others, where the law or the governing document allows that, the actual responsibility still sits with the trustee.

The Charity Commission website provides details of the relatively small number of occasions where it has intervened and gives a picture of its real concerns. These interventions are made under the powers it has under the *Charities Act* and are called Section 8 investigations. Further details from [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)

## 3. Liabilities as a director

Generally a trustee who is also a director or on a committee of an Industrial and Provident Society (IPS) is very much better protected than a trustee who is a trustee of an unincorporated body such as a trust or association. There are, however, duties relating to companies and IPSs which, if neglected, can create personal liability. Failure can give rise to prosecution with fines.

Directors' liabilities can arise if a director fails to:

- follow the rules relating to registration e.g. deliver accounts, file annual returns within the time limits or notify Companies House of change of directors and secretaries or their particulars (but not of changes in directors of the membership of the company)

- give notice of any change of the registered office
- comply with the duties that arise when the organisation faces insolvency (see Section 1, 3.2 Risks not covered by incorporation).



See Companies House guidance *GBAI Directors and Secretaries Guide* (available to download from [www.companieshouse.gov.uk](http://www.companieshouse.gov.uk)) for more information.

## 4. Managing governance liabilities

Governance liabilities are not difficult to manage as long as you have the information.

The starting point is a really effective induction for new trustees. See Appendix 2 for a checklist of suggested material for a trustee induction pack.

Giving people the material is not enough. You need a programme of induction which takes people through the material in the pack, ensures they understand it, and introduces them to the activities, premises and people of the charity.

Induction needs to be followed up by regular training for trustees. There are a number of sources for such training: local councils for voluntary service, conferences run by national organisations such as National Council for Voluntary Organisations (NCVO), and training offered by private providers, particularly specialist accountants and lawyers. For further information see [www.governancehub.org.uk](http://www.governancehub.org.uk).

## Section 3 Understanding operational liabilities

Operational liabilities are liabilities incurred by the organisation because of *what the organisation does*. Unlike governance duties, they do not arise from the trustees' personal duties. Where operational liabilities ultimately fall, if the organisation cannot discharge them, depends in most cases on whether the charity is incorporated (see Section 1). If the charity is incorporated, then operational liabilities generally fall on the organisation. If the organisation cannot meet the liability, it may have to be wound up. But the trustees are not liable. Members' liability is also limited to the amount of their guarantee for a company limited by shares or to loss of the money paid for their shares in an industrial and provident association. If the charity is not incorporated and cannot meet its obligations, the trustee is liable and the members of an association may be liable.



### Case study

A charitable trust loses its grant, closes and cannot pay further instalments on its photocopier hire agreement. The photocopier company can ask the trustee to pay what is due.

Because operational liabilities arise out of what the charity does or does not do, there is an enormous range of acts or omissions that could cause liability. The services you provide, the property you own, the staff you employ, the statements and publications you produce, the people you interact with, the co-operations and collaborative relationships you enter into, the contracts you sign, the funding agreements you enter into and the advice your organisations give all carry potential liability for the organisation.

## 1. Liability for operational risks

Liability can be generated in as many different ways as there are risks. The liability could be to:

- a statutory or government regulator – such as the Health and Safety Commission
- the other party to a contract – when you do not pay what you owe
- to a funder – when you do not complete a project or divert the money for other uses
- to a client for the advice you give when it causes financial loss
- a third party when your mini bus has an accident.

The voluntary and community sector is too varied for it to be possible to specify all the potential risks but in most cases incorporation, care and insurance are the answers to reducing the risk of personal liability.

## 2. Liabilities to staff and volunteers

As soon as an organisation moves from being a purely voluntary body to employing staff, the level of risks that it faces goes up substantially. While the organisation, whether incorporated or not, owes its volunteers a duty of care and a number of other obligations, the range of obligations owed to staff is much larger and more complex and rapidly changing. Key duties and therefore liabilities include:

- financial obligations which include salary, pension, holiday and redundancy pay
- procedural duties, the need to provide disciplinary grievance and other appropriate procedures

- paper work requirements, the obligation to provide a contract or terms and conditions of employment setting out required statutory information
- insurance requirements, not only the need to effect the statutory required employers' insurance but also the need to consider a range of other insurances such as fidelity and personal injury cover
- duties of care particularly under health and safety legislation
- equal opportunities obligations including obligations not to discriminate on the basis of race, sex, age, religion or disability
- a variety of other statutory obligations, for example, not to employ workers who do not have the right to work in this country.

Because of this large number of obligations and because these obligations very frequently lead to claims, employment of staff is one of the key indicators of the need for an organisation very seriously to consider incorporating (see Section 1).

Even with incorporation, there can be personal liability, for example, a staff member may make a claim against a trustee in the employment tribunal alleging discrimination. Here the solution is trustee indemnity insurance (see 4. overleaf), which covers such a claim.

## 3. Managing organisational liabilities

The key tools for managing organisational liabilities include:

- insurance (see Section 4 overleaf)
- acting carefully and thinking about risk
- building financial reserves

- excluding personal liability in agreements and leases where possible
- not taking on long-term commitments
- taking professional advice
- having effective risk management procedures
- seeking Charity Commission or Court relief (which has the power to relieve trustees of liabilities in certain circumstances)
- resignation from the board of an organisation that does not take managing risk seriously
- reviewing the governing document to ensure it contains the widest permitted indemnity provisions, which provide that a trustee is reimbursed if he or she suffers loss or costs in a wide but not unlimited range of circumstances.



Thinking and reading about any area that you are going to get involved in is key. Good sources of information are set out in Appendix 3.

## 4. Insurance

### ***Insuring trustees***

It is possible to obtain an insurance policy to cover some of the governance and some operational liabilities of trustees and of directors discussed in this guidance. This is called *indemnity insurance*.

Before doing so, you need to check whether your constitution explicitly allows the organisation to spend its funds on insuring trustees. The reason for this is that insuring a trustee confers a benefit on the trustee, not the organisation. This breaches the rule

against trustee benefit (see Section 2). Such insurance can only be effected using the charity's money if there is a clause in the constitution authorised by the Charity Commission allowing it to do so. *Note: these rules will change under the new Charities Act 2006, which will allow an automatic right to insure.*

As with any insurance policy, it is vital to recognise exactly what trustee insurance actually covers. Typically it covers:

- omission or negligence
- breach of statutory duty
- errors in investment decisions
- breach of trust
- libel and slander
- wrongful trading
- a wrongful act in respect of an employee (e.g. discriminatory behaviour).

Like any insurance, it will have in the detail of the policy a number of exceptions and limitations and you need to fully understand the extent of these as they can be quite extensive. You will see from the above that such insurance does not cover a wide range of risks that may well worry trustees. For example it will generally:

- not cover personal liability of trustees for claims under contracts or leases
- not provide protection against financial claims or debt which the organisation cannot meet
- not protect against situations where the trustee could be described as having been reckless.

Trustee insurance certainly does provide some cover. However, trustees may be surprised at how limited a range of cover they will get for their premium and many organisations do not for that reason take out trustee indemnity insurance.

One advantage of such insurance is that sometimes people whose skills you need will not join your board unless you have the insurance. In those circumstances, you may consider it a worthwhile premium to pay to get that person to agree to join the board of trustees.



See Appendix 3 for sources of further guidance.

### ***Insuring the organisation***

Insurance of the organisation and its activities and assets is always an important duty for trustees. Clearly it is all the more vital if the organisation is not incorporated since uninsured liabilities not met by the organisation will become trustee liabilities.

Trustees should be careful to ensure that they know that the organisation is properly insured. Key steps to achieving this are:

- understanding what the full range of the organisation's activities are
- considering what sort of insurance is appropriate to cover these
- getting professional advice on appropriate insurance policies
- ensuring that they are kept up to date and premiums are paid
- regular review of the scope and adequacy of insurance arrangements.



See Charity Commission guidance CC49 *Charities and Insurance* for more information.

## **5. What to do when worried about liability**

If you are worried about any element of your obligations as a trustee or the risks attached, you need to resolve that worry quickly. There are a number of ways of doing this.

Consider:

- asking staff or fellow trustees if they can provide you with reassurance
- visiting the Charity Commission website and searching for guidance relevant to your concern
- contacting local or national support agencies, such as a council for voluntary service (CVS), sometimes called voluntary action councils, which exist in many towns and counties. For a full list, see the National Association for Voluntary and Community Action ([www.navca.org.uk](http://www.navca.org.uk))
- doing your own research. The internet is a vast source of information; your local library may also be good. The National Council for Voluntary Organisations ([www.ncvo-vol.org.uk](http://www.ncvo-vol.org.uk)) produces good governance material. See also the *Voluntary Sector Legal Handbook*; a copy which is likely to be available through your local Council for Voluntary Service. See Appendix 3 for more resources
- seeking professional advice. It is very important to select the right professional advisers because charities are a very specialist area and many professionals have had no previous experience in the area. For sources of suitable professionals see Appendix 3
- contact the Charity Commission ([www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)) for advice.

## **But before you seek advice...**

Before you consider taking advice or seeking professional help, think about the following:

- Is this a worry that only you have or do the rest of your committee share it? If there are going to be costs in obtaining this advice, it should normally be the organisation who meets them. However the organisation should not allow trustees to go and obtain expensive advice without it being authorised by the board
- If the worry is serious and you are consulting the Charity Commission, you have to recognise that they are both a source of advice *and* your regulator. If your enquiry reveals a problem, they may take action against you or the organisation as a result.

## Appendix I

### **Jargon and definitions**

**Administrative trustee** – This is just another title for a trustee who runs an organisation as opposed to a holding trustee (see overleaf).

**Constructive trustee** – It is possible to become a trustee without intending it. A person generally becomes a constructive trustee when they acquire property, for example, through fundraising for a charity. They are not entitled because of the circumstances to retain the property. They are in effect another form of holding trustee since they do not have power to direct the use of the property. They merely hold it for the purpose.

A different example of a constructive trustee is where someone gets hold of charity property through some wrong doing. For example, they sell the charity's assets to themselves at an under-value.

The law will treat them as having the duties of a trustee even if they have never been appointed as such.

Shadow trustees and de facto trustees (see overleaf) because they are actually running the charity, in general will have the same duties as a properly appointed trustee and therefore the same potential liabilities.

Constructive trustees generally will have a much more limited position. They will simply be responsible for what they do with the property that they have acquired, so the individual who has gone out fundraising for your charity will have a simple duty to safeguard those funds and pass them on to you. To give you another example, the charity trustee who wrongly grants himself a lease of charity premises will in his role as constructive trustee have a duty to safeguard that asset and return any undervalue or loss to the charity.

**Custodian trustee** – This is a corporate body, the Public Trustee, Treasury Solicitor or Official Custodian, specially authorised to hold assets. The advantage of such a body is that a single trustee

can hold the assets. With Holding Trustees there must always be at least two. Neither holding trustees nor custodian trustees are charity trustees.

**De facto trustees** – These are people who act like trustees, i.e. who take or authorise action and who are held out as being trustees.

**Holding trustees** – These are organisations that may have an additional set of trustees to hold its property. This saves having to appoint new trustees and transfer property to them every time the charity trustees change. This is necessary if an organisation is not incorporated, i.e. a company, industrial society incorporated by act of Parliament or charter. Unincorporated bodies hold property of the organisation in the name of individuals. These individuals hold the property on trust for the organisation. As a holding trustee, the individual will have no power over the assets unless it is specifically given to them by the document appointing them. They may face some liabilities but these will be very substantially less than the administrative/charity trustees. A person may be both a holding trustee and a charity trustee at the same time. Holding trustees are sometimes called nominees.

**Shadow trustees** – Being a trustee is about having power. If someone who does not have any formal role, perhaps a founder who stepped down from the board, but he nevertheless actually controls and directs what the board does and the board feel obliged to following his direction, then that person will also be a trustee albeit a shadow trustee. (See Companies Act, Section 714).

This does not mean that someone who advises trustees, whether they are a lawyer or a senior member of staff, becomes a shadow trustee simply because their advice is followed. What is required is that they are in a position to actually act or instruct the Board.

Only rarely will someone be in a position to consistently direct other trustees as to what they can do.

## Appendix 2

### Suggested material for trustee induction pack

1. Summary of key constitutional provisions
2. Memorandum and Articles of Association or other constitutional documents
3. Any standing orders or by-laws
4. Relevant Policies, e.g. Investments, Reserves, Commercial Partnerships, Recruitment and Induction of Trustees
5. Details of any sub-committees and their terms of reference
6. Detail of any other delegation e.g. powers to offices
7. Charity Commission leaflets in particular:
  - CC3 *Responsibilities of a Charity Trustee*
  - CC60 *Hallmarks of an Effective Charity*These can also be printed from the Charity Commission's website [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)
8. Brief summary of the history of the organisation and mission statement
9. Minutes of previous Trustee meetings and sub-committees
10. Current Strategic plan, cash flow projection and budget
11. Most recent management accounts
12. Last three years' accounts and last annual report
13. Contact details for all other trustees and results of last skill audit

14. Organisational chart and full details and job descriptions for key staff and details of other staff
15. Copies of any existing publications, research documents and other background material
16. Job description for Trustees
17. Trustee Code of Conduct – forms for declaration of interests
18. Copy of last Risk Management Report
19. Expense claims forms and information
20. List of upcoming events including dates of trustee and sub-committee meetings

## Appendix 3

### Sources of further information

#### **Useful publications and websites**

Charity Commission publications, particularly:

*CC3 Responsibilities of a Charity Trustee*

*CC7 Ex Gratia Payments by Charities*

*CC8 Internal Financial Controls for Charities*

*CC9 Campaigning and Political Activities for Charities*

*CC11 Payment of Charity Trustees*

*CC14 Investment of Charitable Funds*

*CC19 Charitable Reserves*

*CC20 Charities and Fundraising*

*CC22 Choosing and Preparing a Governing Document*

*CC24 Users on the Board: Beneficiaries who Become Trustees*

*CC27 Using Alcohol on Charity Premises*

*CC28 Disposing of Charity Land*

*CC29 Charities and Local Authority*

*CC33 Acquiring Land*

*CC35 Charities and Training*

*CC37 Charities and Contracts*

*CC49 Charities and Insurance*

*CC60 The Hallmarks of an Effective Charity*

Charity Commission, PO Box 1227, Liverpool, L69 3UG,

T: 0845 3000 218, [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)

Companies House, Crown Way, Maindy, Cardiff, CF14 3UZ,

T: 0870 33 33 636, [www.companieshouse.gov.uk](http://www.companieshouse.gov.uk)

National Council for Voluntary Organisations, Regent's Wharf,

8 All Saints Street, London, N1 9RL, T: 0800 2 798 798,

[www.ncvo-vol.org.uk](http://www.ncvo-vol.org.uk)

*The Voluntary Sector Legal Handbook* by James Sinclair Taylor and Sandy Adirondack. Available from Directory of Social Change, 24 Stephenson Way, London, NW1 2DP, T: 08450 77 77 07, [www.dsc.org.uk](http://www.dsc.org.uk)

*Voluntary but not Amateur: A Guide to the Law for Voluntary Organisations and Community Groups* by Jackie Reason and Ruth Hughes. Available from London Voluntary Service Council, 2nd Floor, Resource Centre, 356 Holloway Road, London N7 6PA, [www.lvsc.org.uk](http://www.lvsc.org.uk)

## **Other sources of help**

### **Insurance providers**

To source a suitable insurance provider, contact the Association of British Insurers, 51 Gresham Street, London EC2V 7HQ, Tel: 020 7600 3333, [www.abi.org.uk](http://www.abi.org.uk) or the British Insurance Brokers' Association, 14 Bevis Marks, London EC3A 7NT, Tel: 0870 950 1790, [www.biba.org.uk](http://www.biba.org.uk)

Examples of some providers/brokers known in the sector include:

Aon Risk Services, 5th Floor, Capital House, 1 Houndwell Place, Southampton, Hampshire SO14 1HU, Tel: 08457 697504, [www.aon.co.uk](http://www.aon.co.uk)

Ladbroke, Freepost NEA9003, Sheffield S25 3ZZ, Tel: 01909 565858, [www.ladbroke.co.uk](http://www.ladbroke.co.uk)

The Encompass Policy is provided by the National Council for Voluntary Organisations in conjunction with Keegan and Pennykid Insurance Brokers and Royal & Sun Alliance. Keegan and Pennykid Insurance Brokers, 50 Queen Street, Edinburgh, EH2 3NS, Freephone 0800 731 8030, [www.keegan-pennykid.com/charities/policy\\_details/index.html](http://www.keegan-pennykid.com/charities/policy_details/index.html)

Charity Trustee Networks offers indemnity insurance for individual trustees and management committee members, as part of a wider package of benefits. Members of CTN's free national network of trustees, at [www.trusteenet.org.uk](http://www.trusteenet.org.uk), will be able to purchase these optional discounted packages early in 2007. For more information, visit the website or contact Kathy Burges, Tel: 01483 230282 or Email: [kathy.b@trusteenetworks.org.uk](mailto:kathy.b@trusteenetworks.org.uk)

### **Sources of professional advice**

To source a suitable professional adviser, you may like to use information available through the following associations.

Charity Law Association, Shivaji Shiva, Honorary Secretary, Russell Cooke, 2 Putney Hill, Putney, London, SW15 6AB, Tel: 020 8394 6486, [www.charitylawassociation.org.uk](http://www.charitylawassociation.org.uk)

Association of Chartered Certified Accountants, 29 Lincoln's Inn Fields, London WC2A 3EE  
Tel: 020 7059 5000, [www.accaglobal.com](http://www.accaglobal.com)

Charter Institute of Management Accountants, CIMA, 26 Chapter Street, London, SW1P 4NP, Tel: 020 8849 2251, [www.cimaglobal.com](http://www.cimaglobal.com)

Institute of Chartered Accountants, Chartered Accountants' Hall, PO Box 433, London, EC2P 2BJ, Tel 020 7920 8100, [www.icaew.co.uk](http://www.icaew.co.uk)

Bear in mind that only a limited number of solicitors specialise in advising charities and have an in-depth knowledge of trustee responsibility and risk. These areas do not form part of the work of the average solicitor. Using the web is one of the best ways to assess whether a solicitor has the sort of experience needed to help with your problem. An alternative would be approaching local voluntary organisations and umbrella bodies, but do check that you are dealing with a genuine specialist before going forward.