Good Practice: Trustees Duties

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Charitable Companies – Directors' Duties

Directors of charitable companies have duties both as charity trustees and as company directors.

Duties of Charity Trustees

I. These include various specific statutory duties such as the duty to prepare annual accounts and an annual return and common law fiduciary duties.

II. In broad terms Charity Trustees must accept ultimate responsibility for directing the affairs of a charity, and ensuring that it is solvent, well-run, and delivering the charitable outcomes for the benefit of the beneficiaries for which it has been set up.

III. In more detail

Trustees must:

1. Ensure that the charity complies with charity law, and with the requirements of the Charity Commission as regulator.
2. Ensure that the charity prepares reports on what it has achieved and Annual Returns and accounts as required by law, study those reports and accounts and where necessary ask for an explanation.
3. Ensure that the charity does not breach any of the requirements or rules set out in its governing document and that it remains true to the charitable purpose and objects set out there.
4. Comply with the requirements of other legislation and other regulators (if any) which govern the activities of the charity.
5. Act with integrity, and avoid any personal conflicts of interest or misuse of charity funds or assets.
6. Ensure that the charity is and will remain solvent.
7. Use charitable funds and assets reasonably, and only in furtherance of the charity's objects.
8. Avoid undertaking activities that might place the charity's endowment, funds, assets or reputation at undue risk.
9. Take special care when investing the funds of the charity, or borrowing funds for the charity to use.
10. Use reasonable care and skill in their work as trustees, using their personal skills and experience as needed to ensure that the charity is well-run and efficient.
11. Meet regularly.
12. Consider getting external professional advice on all matters where there may be material risk to the charity, or where the trustees may be in breach of their duties.

Directors of a Charitable Company

IV. The main duties of company directors are summarised as follows.

V. A duty to act within the powers of the company

This means acting in accordance with the company's constitution and only exercising powers for the purposes for which they are conferred, that is in order to advance the charitable objects of the company.

VI. A duty to promote the success of the company

A director must act in the way he considers, in good faith, would be the most likely to promote the charitable purposes of the company. In doing so he must have regard (among other things) to:

1. The likely consequences of any decision in the long term.
2. The interests of the company's employees.
3. The need to foster the company's business relationships with suppliers, customers and others.
4. The impact of the company's operations on the community and the environment.
5. The desirability of the company maintaining a reputation for high standards of business conduct.
6. The need to act fairly as between members of the company.

Charitable companies which do not fall with the exemption for 'small companies', must include in the directors' report a business review designed to inform the members and help them to access how the directors have fulfilled their duty to promote the success of the company. It must contain a fair review of the company's business and a description of the principle risks and uncertainties facing the company. This is likely to include much the same information which goes into the annual report which a charity is required to submit to the Charity Commission.

VII. A duty to exercise independent judgement

A director must exercise his powers independently, without being influenced by a third party. This duty does not prevent a director from exercising a power in the articles to delegate. The board of directors of some charitable companies will include individuals who are directors of other companies which fund or otherwise deal with the charitable company. Directors who serve on both boards will need to take extra care to ensure that their decisions are genuinely independent, and are in the best interests of the charitable company.

VIII. A duty to exercise reasonable care, skill and diligence

A director must exercise:

1. Such general knowledge, skill and experience as may reasonably be expected of a person carrying out the functions of a director in relation to the company; and
2. The general knowledge, skill and experience that he or she has.

A professional person who is a director of a charitable company will, therefore, be subject to a higher duty of care. The directors may take legal or other professional advice to enable them to discharge the duty of care.

IX. A duty to avoid conflicts of interest

A director, must avoid a situation in which he has, or can have, a direct or indirect interest which conflicts, or may conflict, with the company's interests. The duty applies in particular to the exploitation of any property, information or opportunity and applies whether or not the company could take advantage of the property, information or opportunity.

The duty does not apply to a conflict of interest arising from a transaction or arrangement with a charitable company to the extent that the articles allow that duty to be disapplied. The directors of a charitable company may only authorise a conflict of interest arising in relation to a transaction or arrangement if the charity's constitution allows this.

Conflicts of interest relate to a divergence between a director's personal interest and his duty to the company. Common areas of difficulty include:

1. The employment of a trustee or a connected person.
2. A trustee being paid to provide professional services to a company.

X. A duty not to accept benefits from third parties

A director must not accept a benefit from a third party conferred by reason of his being a director or his doing (or not doing) anything as a director.

XI. A duty to declare an interest in a proposed transaction or arrangement

If a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to his fellow directors before the company enters into the arrangement. A director need not declare an interest if:

- It cannot reasonably be regarded as likely to give rise to a conflict of interest .
- The other directors are already aware, or ought reasonably to be aware, of it.

However, it is generally safer to declare an interest.

The fact of disclosure does not necessarily confer a power on the company to enter into a contract. The conflict of interest must be permitted in the memorandum or articles. The members of a charitable company may only authorise transactions which could constitute a breach of the duty to avoid conflicts of interest or the duty not to accept benefits from a third party if the articles specifically allow those duties to be disapplied.

Where there is any doubt, it is possible to approach the Charity Commission to seek authorisation for a particular act. The commission may do so even where the act involves a director's breach of duty.

XII. Transactions with directors

Certain transactions between a charitable company and a director require members' approval:

- A transaction between a company and a director or a connected person in relation to a non-cash asset which either exceeds £100,000 in value or exceeds 10% of the company's asset value and is more than £ 5,000 (previously £2,000 under the 1985 Act).
- Loans of more than £10,000 made by a company to a director (under previous law, loans to directors were prohibited, apart from certain loans of less than £5,000).

Any members' approval of a transaction between a charitable company and a director is ineffective without the Charity Commission's prior written consent.

XIII. Duties on Insolvency

One area in which personal liability is a particular risk is insolvency. If a charitable company becomes insolvent , the duties of the directors change from pursuing the interests of the company to safeguarding creditors. The directors/charity trustees may be personally liable if they continue to 'trade' when they should not have done so. This may amount to either 'wrongful trading' or 'fraudulent trading' for the purposes of the insolvency rules and give rise to personal liability. Where insolvency is suspected, it is important to take prompt advice from an appropriate professional.