

# The Burden of Responsibility

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Although directors and trustees are often one and the same, their legal responsibilities and duties are distinct. Since these roles can make the individual liable for a charity's activities or lead to fines for malpractice, it's essential to understand the full implications of holding any title. It's also important to understand what is required of each individual post holder since the actions of one person can impact on another.

This need for awareness has become critical now that so many charities are opting for incorporation or run limited liability offshoots. Whilst having limited liability subsidiaries can afford tax advantages and facilitate VAT recovery, it means the subsidiary and the charity could be liable to company law.

This article explains the scope of directors' and trustees' obligations and suggests ways in which they can manage personal liability.

## **Trustees**

To assess the precise duties and responsibilities of trustees it is useful to look back at the formation of the charity since the manner in which this was done determines the governing document and the roles of those involved.

An unincorporated association, for example, has a constitution that stems from its rulebook and is governed by trustees who form a management committee. Charitable companies have a 'Memorandum and Articles of Association' which means their trustees are also directors. Charitable trusts are formed from a trust deed or will and the trustees are simply known as 'trustees'. Whatever the constitution, charity trustees are responsible for administering and controlling the charity which gives them far ranging

obligations. More importantly, they can be *personally* liable for the charity's activities.

Custodian trustees hold legal title to property and investments belonging to the charity and normally act on the instructions of the trustees. They do not have a management role. Custodian trustees are often appointed by unincorporated charities as a means to hold legal title to property or investments.

Another route to holding property and investments is through incorporation via the Charities Act of 1993. This also brings the advantage that assets do not need to be transferred upon any change in trustee. However, incorporation does not protect trustees with limited liability status, so they may remain personally exposed to loss.

Trustees can also be appointed by outside organisations, which have an interest in the charity's work, e.g. a local authority funder. Nominated trustees, as they are known, have the same responsibilities and legal duties as charity trustees.

#### **Trustees defined**

- Charity trustees: responsible for administering and controlling the charity in accordance with the constitution. May face personal liability.
- Custodian trustees: hold title to property and investments. No management role.
- Nominated trustees: appointed by outside organisation. Have similar responsibilities as charity trustees

## **Reasonable Care**

Trustees must act reasonably and prudently with regard to all charity matters. Case law has built up over many years with the effect that trustees are legally required to exercise the same degree of care as a prudent businessman.

The use of funds and assets must naturally support the constitution whilst income should not be accumulated without a specific future purpose. Trustees have a duty to identify work carried out by similar organisations in either their geographical area or operational sector and if appropriate develop partnerships or umbrella associations to maximise efficiency.

Although trustees may delegate tasks to others in the organisation or by outsourcing various functions, overall responsibility remains with the trustees (except for incorporated charities or charitable companies, see following paragraph). In all cases, a contract is a sensible precaution to confirm what is expected of third parties and makes the relationship binding. Provided trustees act prudently and lawfully any liabilities incurred by third parties can normally be paid out of the charity's resources. However, if trustees are in breach of trust then they are *jointly and personally* liable to deal with the consequences. It's worth remembering that this liability can often be limited by including a clause in the contract to restrict liability to the value of the charity's assets.

If a charity is registered as an incorporated company, contracts are made between the charity (a separate legal entity from the trustees) and the supplier. As a result, the trustees have no personal liability under those contracts.

Fortunately, today's governing documents normally allow trustees to insure against personal liability for acts carried out in breach of trust and honest mistakes. Charity funds can generally be used for this. It is also advisable to take out employer's and public liability insurance as charities have the same responsibilities to staff and members of the public as any other organisation.

If a charity's constitution was drawn up a long time ago and does not specifically allow insurance it may be possible to update the constitution.

### **Safeguarding assets**

This is where the potential overlap between trustees and directors tends to occur as both directors and trustees have a duty to safeguard a charity's assets. By and large, trustees control the overall direction of the charity and may eventually be held personally liable. Directors are typically appointed to deal with day to day operations in accordance with members' requests and have strict financial obligations as stated in company law. Directors can be fined for non-compliance with the Companies Act . Specific powers of directors should be outlined in the charity's Article of Association.

Generally speaking, unincorporated charities and charitable trusts do *not* automatically have directors, whereas charitable companies and incorporated charities *do* have directors.

Where charities are involved in fund raising, trustees are responsible for ensuring that the activity is properly carried out and accounted for. Indeed, trustees are ultimately accountable for the solvency of the charity and must also ensure that financial and other controls are instigated and maintained.

The Charities Act of 1993 requires trustees to maintain accounting records, prepare accounts and an annual report that is subject to audit or independent examination. Their accounts should be made available to the public. It is the responsibility of the trustees to ensure that the annual accounts, report and annual return are submitted to the Charity Commission.

Trustees' powers to invest are either contained in their charity's governing document or else based on the Trustees' Investments Act of 1961. Any investment should be carefully considered by reference to both the long and short term needs of the charity.

### **Director's v Trustees**

Consult the charity's constitution and Articles of Association (where appropriate), but the following compares typical key duties

- **Trustees**
- Responsible for overall management and direction
- Ultimately responsible for safeguarding charity assets
- Face potential personal unlimited liability
- Must ensure proper accounts are maintained and submit annual return, report and accounts to charity commission
- Ensure solvency of charity

### **Directors**

- Normally responsible for financial affairs
- Should know company's financial position at any given time
- Liable to personal fines or barred from future office for bad management – not subject to unlimited personal liability unless acting beyond their powers.
- Responsible for day to day management in accordance with trustees' aims
- Prepare accurate accounts, annual return and reports which must be submitted on time to Companies House

The owners of companies, be they charitable or not, can limit their liability in one of two ways. Firstly, if share capital is issued, shareholders (who may also be trustees and/or a directors) are liable up to the nominal value of those shares in the event of insolvency. Most subsidiaries of charities are set up in this way so that the liability of the charity is confined and minimised.

A second option is to establish a company, which is limited by guarantee. In this situation there are no shareholders but the members of the company

guarantee to pay a certain amount of money in the event of that company's failure. Incorporated charities are normally limited by guarantee.

Consequently, an individual can wear many different hats at the same time. They could be a member who has given a guarantee for an incorporated charity, a trustee and/or director of that company as well as being a director and shareholder of the subsidiary. It is not surprising then that there is often confusion over exactly what each person's responsibilities and duties are!

## **Directors**

The members (or shareholders) of a company appoint the directors who take responsibility for the day to day operations and strategy of that company. Directors must act in accordance with the wishes of the members and if necessary, can be removed at the Annual General Meeting. Their specific powers should be explained in the charity's Articles of Association.

Company Law states that directors are responsible for the preparation of financial statements and selection of suitable accounting policies, which have to be applied consistently. They are also responsible for keeping proper accounting records that disclose with reasonable accuracy *at any time* the financial position of the company. Like trustees, directors have responsibility for safeguarding assets. They should also take reasonable steps to prevent and detect fraud and other irregularities.

The Companies Act also requires directors to ensure that annual returns are properly completed and filed on time. Additionally, directors should ensure that changes in directorship or with the company secretary are notified to Companies House. This Act also means directors can be fined or barred from office for not meeting their responsibilities.

In the same way that directors owe a fiduciary duty to the company, they owe the same duty to the company's employees. Although directors can be exempted from liability under the Articles of Association this does not apply if

the liability arises through negligence or misdemeanour. Insurance can be purchased by the company to cover this liability.

Because of the growing complexity of many charities, trustees and directors should be fully aware of their own and their colleagues' responsibilities. This is particularly relevant for trustees of incorporated charities and those connected to charities with limited company subsidiaries where company law as well as charity regulations apply. But with appropriate advice, steps can be taken to reduce personal risk.

## **MANAGING PERSONAL LIABILITY**

**Directors and Trustees should act prudently and follow the aims of the constitution. The activities of one can impact on others, so they should be aware of their colleagues' actions.**

### **Trustees**

- Insure against personal loss (check that the constitution permits this)
- Arrange insurance for public and employer's liability
- Instigate appropriate financial controls and accounting records to cover investments, fundraising and assets. Use of funds should support constitution
- Outsourced activities: incorporated charities may limit liability to value of charities assets

### **DIRECTORS of trading subsidiaries with company status**

- Articles of Association can limit liability
- Insure against directors' potential personal loss

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### **Additional Information**

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