



Avoiding legal pitfalls

The Chair's Challenge Series

A literature review

1 Introduction

There are some topics that pose particular challenges for the Chair of the board, but on which there is little guidance written from the Chair's perspective. The Chair's Challenge Series is the Association of Chairs new programme of briefings and events to explore these issues. We are producing a briefing for each topic to identify key issues for Chairs, and how Chairs can manage the challenge. Each briefing can be downloaded from our website, once published. The briefings are based on a literature review of what already exists that may be relevant and useful, and on discussions with experienced Chairs.

This literature review seeks to identify relevant research and resources concerning the Chair's role in helping the charity to avoid legal pitfalls. The purpose is to highlight findings and resources that may be useful to Chairs, and to identify gaps that it would be helpful to address.

2 Summary

Charities and their trustees are subject to a range of laws and regulations depending on what they do and how they are constituted. As the Charity Commission states in its guidance *The essential trustee: what you need to know, what you need to do*¹, the regulator does not expect every trustee to be a legal expert. However, it does expect trustees, led by the Chair, to take reasonable steps to find out about legal requirements that apply to them, keep up to date with changes and have systems and procedures in place to ensure compliance. The Commission also makes clear that charities should also take professional advice where they don't have the expertise themselves.

The number of charities subject to compliance and enforcement action by the Charity Commission is proportionately small, but rising. In its annual report for 2016–17², the Commission reported that 248 charities were subject to an inquiry at the end of the year, compared to 135 in the previous year. This still equates to less than 1% of the 167k charities on the register. The Commission, however, indicates that their approach to tackling abuse and mismanagement in charities "continues to be a strategic priority and where we direct most of our regulatory engagement with charities." Resources are being put towards more proactive identification of risk areas with the establishment of a Risk Assessment Unit within the Commission. Charities will, therefore, continue to be scrutinised and the trustees, driven by the Chair, now more than ever, need to ensure that they have systems in place to assure themselves



that they are operating within the law and continue to retain the confidence of their beneficiaries and the wider public.

*Taken on Trust*³, recent research on the awareness and effectiveness of trustees identified that trustees are generally confident in their own awareness of legal duties and responsibilities, but that in practice they “are less confident when specific responsibilities are identified and tested. The researchers say that their findings suggest that there might be something of a gap between a trustee’s perception of and actual knowledge of their legal duties.” This is a slightly worrying picture and Chairs have a role in ensuring that the actual knowledge and ongoing updating of that knowledge is in place for the whole trustee board.

There are various things that the Chair can do to help trustees avoid legal pitfalls and minimise the risk of things going wrong, including ensuring that:

- The charity has arrangements in place for the effective induction of all trustees alongside a programme of ongoing learning
- All trustees have access to, read and understand their governing document and have an awareness of the law that impacts on their charity
- The charity has in place appropriate policies and procedures, and they are operated effectively
- Consideration is given to putting in place an assurance framework, appropriate to the charity’s size and activities
- The board takes appropriate advice when needed.

3 What does the Regulator and the Code of Practice tell us?

Charity trustees are responsible for their charity and must have systems in place to ensure that they protect their charity from any abuse or mismanagement.

In its guidance *The Essential Trustee: what you need to know, what you need to do*⁴ the Charity Commission makes it clear that trustees who act in breach of their duties can be responsible for any resulting loss, and that the Commission “may take account of evidence that trustees have exposed the charity, its assets or its beneficiaries to harm or undue risk by not following good practice.”

The Commission summarises the trustees’ main legal responsibilities as:

- Ensure your charity is carrying out its purposes for the public benefit.
- Comply with your charity’s governing document and the law.
- Act in your charity’s best interests.
- Manage your charity’s resources responsibly.
- Act with reasonable care and skill.
- Ensure your charity is accountable.

In its most recent report⁵ on how it tackles abuse and mismanagement, the Charity Commission states that “Only a relatively small proportion of registered charities have such serious problems that they become subject to a compliance case or investigation by the Commission. But all charities can be vulnerable to abuse or mismanagement if their trustees have not put in place robust systems to protect their charity from harm,

and crucially, if they don't use them. Sometimes trustees may make honest mistakes that lead to further difficulties."

*The Charity Governance Code*⁶ states that as a starting point all trustees must "understand their roles and legal responsibilities" and all other aspects of good governance build from this foundation.

4 Case studies

Charities cannot always avoid significant problems, but cases reported by the Charity Commission usually identify a governance failure that led to things going wrong. The following section identifies some case studies where charities came unstuck and outlines where the charity's board could have put measures in place to prevent, or at least lessen the extent of the issues.

Operating beyond the terms of the governing document

The board of trustees must be clear about the purposes of their charity and operate within those purposes.

Oxley Park⁷ was a charity set up to provide an open space for recreation. The sole trustee was Sheffield City Council. Some time ago, part of the land belonging to the charity had wrongly been used to build a leisure centre. This was outside of the charity's objects. The issue came to light when the Council decided to close the leisure centre, against the wishes of the local community. The Commission published a report on its intervention, identifying that the building of a leisure centre was a breach of trust in the use of a recreation ground. The report highlighted the requirement for trustees to ensure that charities work within their stated purposes. The Commission decided that due to local support, the objects of the charity should be widened to allow for a new centre to be built. However, it cautioned that "often breaches of trust have very serious regulatory consequences for charities and for trustees, especially when the charity loses out financially as a result."

Lack of governance grip

The board of trustees is ultimately responsible for the charity and take collective responsibility. However, some trustees can absent themselves from the decision-making process to the point where they are not in control.

An example of this is a regulatory case opened by the Charity Commission into the Bhagavat Educational Trust⁸. The trustees had not held meetings for two years and although the charity was meeting its aims and using its funds appropriately, this was down to the staff, not the trustees. Trustees did not properly delegate authority to staff and had few procedures in place to monitor what was going on. The Commission found that there was a "serious failure of governance" and that it was "an unacceptable way for the trustees to run a charity." As a result of the Commission's intervention, the charity reviewed its governance and improved its financial controls to the Commission's satisfaction.

Ineffective accountability and decision making

Ensuring accountability to beneficiaries and other stakeholders is an important duty of trustees. Where this does not happen, this can cause problems.

St Bees School was an independent day and boarding school.⁹ The trustees had been aware of diminishing numbers of pupils more generally in the independent sector. There was a question of a long-term decline in the financial sustainability of the charity that was not, perhaps, fully explained in previous accounts. Therefore, parents of pupils felt that they had not been adequately informed about the reasons for closure.

The Commission found that there was no mismanagement or misconduct by the trustees and that the decision to close the school was properly taken and followed the specific requirements in the governing document about making decisions and conducting meetings. However, how meetings with stakeholders were conducted and how the decision was taken, risked a public perception that the decision had not been made properly.

Lack of financial sustainability

All charities are operating in a time of financial uncertainty and this makes effective financial planning vital to ensure a charity can operate within the law, or meet its obligations should it have to cease activities.

The Charity Commission noted in its last annual report the importance of trustees managing financial difficulties. In response to this, they produced a report highlighting the challenges that the difficult financial environment presents for charities and some of their strategies for dealing with them.¹⁰

The most recent, and high-profile example of a charity lacking in suitable financial planning is the case of Kids Company. The Public Administration and Constitutional Affairs Committee published a report identifying what lessons could be learned from the collapse of Kids Company¹¹. Clearly there were many issues that arose that contributed to the charity failing, but the lack of adequate reserves was highlighted. The report states that “Although the charity’s auditors always signed off Kids Company’s accounts as a going concern, each Annual Report warned that future activity would depend almost entirely on the charity’s ability to secure continuing grant income. Management letters also issued Trustees with repeated warnings relating to potential insolvency and the sustainability of the charity. These warnings did not lead to any perceptible change of policy on the part of Trustees.”

The trustees themselves had identified in 2013 that the principal risk to the charity was financial including the need for sufficient reserves. Kids Company had always worked on a demand led model, indicating that there was increasing demand from its beneficiaries. However, the Charity Commission noted that “if it is a charity that is providing services or has employees or it is working with vulnerable beneficiaries, the Trustees have a higher duty of care to make sure that their financial planning and their business model is much more robust, and the safeguards are there.”

Kids Company argued that they needed to meet the increasing demand, but ultimately not prioritising building adequate reserves contributed to the demise of the charity altogether.

Failing in responsibilities as an employer

Boards of charities that employ staff need to be aware of and seek professional advice on employment practices. Charities, like any other employer, have to work within employment law and if they do not, they can suffer legal consequences. The Chair, in particular, will usually act as line manager of the Chief Executive and it is vital that this role is carried out effectively.

In 2016 the Terrence Higgins Trust lost an employment tribunal case brought by their former Chief Executive¹². The Chief Executive was recruited in 2014 but dismissed 16 months later. The then Chair was criticised by the Tribunal for his evidence, particularly related to the issue of performance. The Chair contended that the trustees had long-standing concerns with the performance of the Chief Executive, but had, just three months before the dismissal, sent an email praising the Chief Executive's performance. The Chair contended that this was sent to boost morale. Prior to the dismissal, the Chief Executive had also reported allegations of sexual harassment by a trustee against a member of staff.

The relationship between the Chair and Chief Executive in particular, and the role of the board as a whole as employer, is key. Trustees must operate within HR law.

Not protecting beneficiaries

Charities have a general duty of care to protect their beneficiaries and, in particular, must have systems in place to protect vulnerable beneficiaries. The case of the charity International Tiger Moth¹³ concerned lack of protection of vulnerable beneficiaries, particularly regarding risk to their safety. The charity, which is no longer operating, provided flights for sick and terminally ill children. The trustees had failed to ensure that a Certificate of Airworthiness had been obtained for all charity flights, leading to concerns over the validity of their insurance cover.

They were also found to lack a safeguarding policy and had not considered the suitability of the volunteer pilot. The Commission noted that trustees "must comply with legislation that protects the health and safety" of beneficiaries and those working with the charity. "Trustees are expected to find out what the relevant law is, how it applies to their organisation and to comply with it where appropriate." The Commission also noted that all charities should regularly review risks and have systems in place to manage those risks.

More recently, in December 2017 the Charity Commission published a case report on Oxfam¹⁴ after it had engaged with the charity over its handling of a number of allegations about various safeguarding incidents involving senior programme staff, including allegations of sexual harassment of other staff. Many of the allegations reported against the senior country staff relating to sexual abuse and exploitation were not substantiated, and the Commission did not see any indication to suggest that the risks to staff at Oxfam were any greater than those facing staff in other

similar organisations. However, the regulator did find incidents of behaviour that did not meet the organisation's culture and values, and which brought into question how confident trustees could be in the charity's wider people management systems. It also identified some weaknesses in how trends in safeguarding allegations were picked up, reported to trustees and management follow up properly agreed. Oxfam has agreed a programme of work to address these issues, and the Commission plans to publish a 'lessons for the sector' report in Spring 2018. In the meantime, the regulator has issued an alert urging charities to review their safeguarding and governance arrangements.¹⁵

Ineffective response to fraud

Like all sectors, the charitable sector can fall victim to fraud. Having the right financial systems in place can help protect the organisation. However, where fraud is detected, it is important that the board responds effectively.

In the Charity Commission's *Tackling Abuse and Mismanagement*¹⁶ report for 2012–13, the regulator highlighted the case of the Christadelphian magazine and Publishing Association Ltd. The charity promoted the Christadelphian faith. The charity reported a serious incident to the Charity Commission of a theft of around £290,000 by a trustee, who was also employed by the charity. The Commission noted that the other trustees did the right thing by reporting the matter and taking immediate steps to dismiss the staff member and remove him from his paid position.

However, the trustees refused to report the matter to the police because they had sought agreement (although not formal) from the trustee that he would repay the funds.

The Commission reported the crime to the police and ensured that that the trustees took out a formal legal charge against the home of the former trustee so that the charity would be paid back the remaining charitable funds once it was sold. The trustees were reminded of their legal duties, including the duty to put in place proper internal financial controls to protect the charity's assets.

Unauthorised private benefit

In the Charity Commission's *Tackling Abuse and Mismanagement*¹⁷ report for 2015–2016, it says that governance issues, including unauthorised private benefits, feature in its compliance work. The regulator cites the example of the charity *Deafinitions*¹⁸ whose accounts showed that three of the charity's four trustees were benefiting privately from the charity, contrary to the charity's governing document. The Charity Commission found the charity trustees were being employed as staff members because no external candidates had come forward. The Commission regularised this situation, but insisted that the majority of the trustees should be unpaid, so they could review payments to trustees and ensure they were in the charity's best interests.

Unmanaged conflicts of interest

In many charities the personal and professional connections of those involved in the organisation can bring benefits to the work of the charity. However, they can give rise to conflicts of interest, which, if left unmanaged, can result in difficulties and suggestions that the trustees are not working in the best interests of the charity.

My Community UK¹⁹ was set up to relieve poverty, advance education and promote good health among individuals in need, primarily, but not exclusively, for the Muslim community. As part of an investigation into the charity, the Commission found that there was evidence of unmanaged conflicts of interest, conflicted loyalties and connected party transactions, involving current and former trustees who were related, where payments were made to set up an IT infrastructure. These payments were found to be in breach of the charity's governing document due to conflicts of interest.

On this issue, the Charity Commission concluded that "Whilst payments to connected parties for computer software and support services had been made historically without adequate decision making and recording of decision making, there was some evidence that computer software and support services had been provided. The current trustees have improved in this area; decision making is now documented and a conflicts of interest policy is in place and appears to be followed."

In the recent research 'Taken on Trust' Chairs reported high levels of personal responsibility for avoiding conflicts of interest in board meetings and in the charity's operations. Although this is not a responsibility for the Chair alone, it is a role for the Chair to lead on ensuring that conflicts are managed effectively.

Protecting information

This issue is particularly current, with thirteen charities facing major fines by the Information Commissioners Office (ICO)²⁰ since December 2016. These related to data breaches where charities were found to have screened millions of donors so that they could be targeted for more funds. There was also evidence that some also traded personal details with other charities. Information Commissioner Elizabeth Denham was quoted as saying "we acknowledge the role charities play in the fabric of British society. But charities must follow the law."

These breaches not only impact on the charities financially, but also reputationally, for themselves and the wider sector. This is another example of wider legal requirements, which apply to all organisations and not just charities, where trustees must ensure compliance.

5 How to minimise the risks of things going wrong

The importance of induction and ongoing information

Ensuring early and full induction is an important first step to ensuring that trustees are aware of all of their responsibilities. The Charity Governance Code states that trustees should "receive an appropriately resourced induction when they join the board. This includes meetings with senior management and covers all areas of the charity's



work.” It also recommends that trustees are given the opportunity to have ongoing learning and development. Legislation and good practice changes and develops all the time, so it is vital that trustees continually develop their knowledge and are supported and encouraged by the Chair to do so.

Understanding your governing document and the law

Trustees must read and most importantly, understand the provisions of their governing document, as this sets out what they can and cannot do. It is useful to have the governing document available to all trustees so that they can refer back to it when making decisions. The governing document will set out what the charity does, who it helps, how it will help and where it operates. It will also set out certain powers and how it should be run.

Each charity will be subject to charity law, but charitable companies will also be subject to company law and, depending on its activities, a charity will be subject to a range of other legislation. The Charity Commission for England and Wales sets out some of the areas that a charity might operate in where other legislation might apply, for example where it:

- is a company, community interest organisation (CIO) or community benefit society
- employs staff
- owns or rents premises
- operates vehicles
- provides:
 - legal, financial or other regulated advice
 - housing or accommodation
 - medical or care services
- works with children or vulnerable adults
- undertakes activities that are subject to regulations, such as fundraising
- wants to benefit from Gift Aid or other tax reliefs
- works in Scotland, Northern Ireland or outside the UK.

Effective policies and procedures

Different types of charities will need different policies and procedures in place, but most charities would need to have effective financial controls in place, schemes of delegation setting out in what circumstances the trustees can delegate functions and how this is overseen (particularly where there are staff), reserves policies, conflicts of interest policies, risk policies and codes of conduct. Other policies such as those around whistle-blowing, anti-discrimination, health and safety and protection of vulnerable beneficiaries, might depend on the charity’s activities.

Charity assurance framework

A useful tool for trustees who wish to ensure that they receive accurate information relating to the charity’s goals and areas of risk is a board assurance framework (BAF).



ICSA, the governance institute²¹ has produced a guidance note, which can be downloaded from their website, setting out how to build a framework.

The BAF should highlight the main sources of information available to the charity and this, in turn, will highlight any gaps. ICSA identifies the benefits of a BAF as:

- a clear and comprehensive overview of the charity's risks, including the management and mitigation of those risks
- identifying where there is insufficient assurance available and strengthening those controls
- highlighting areas of overlap, duplication or disproportionate control mechanisms
- flagging up where control mechanisms are ineffective or inefficient
- focussing limited resources at those areas of greatest need, and
- providing evidence to support formal governance statements.

Key to supporting a BAF is to have a corporate calendar in place, led by the Chair, to decide which items are placed on the agenda of every meeting to ensure that timely information on legal requirements is available to the Board.

Taking appropriate advice

Trustees are not expected to be experts in every aspect of their charity, but should know when they should seek professional advice. In 'The Essential Trustee: what you need to know, what you need to do' the Charity Commission advises that trustees must "use reasonable care and skill, making use of your skills and experience and taking advice when necessary." They say that this is particularly important when:

- buying or selling land (most charities must take advice from a surveyor or other qualified person when selling charity land)
- investing charity funds
- entering into novel, long-term, complex or high-value contracts
- considering legal action.

But trustees should seek advice in any situation where they are unsure.

There are also many sources of free information for trustees, such as the Charity Commission website www.gov.uk/government/organisations/charity-commission

6 Conclusion

There are some key lessons for trustees and Chairs as leaders of their Boards, from cases where things have gone wrong.

Ignorance is not bliss. Trustees need to be aware of what their role entails and receive ongoing support to keep up to date with changes in legislation that affect their role and the work of the charity. They need to access guidance from sources such as the Charity Commission. It is helpful to keep abreast of issues within the sector through free updates (for example from professional advisers and from magazines) including from the Commission itself to be alert to problems other charities are facing or where good practice can be drawn.

Understand your responsibilities from the start. The Chair should take a particular responsibility for new trustees receiving an effective induction that outlines the legal

duties of a trustee and the particular responsibilities that arise from the particular activities of the charity and how it is set up.

Prevention is better than cure. Chairs need to work with their trustees and the senior executives (if they have them) to ensure that proper systems, procedures and report back facilities are in place, such as clear delegations, systems of financial control, effective approaches to risk management and that the right people, with the right training are in place to carry out functions. When the worst happens, trustees should have in place clear contingency plans to cope with a significant problem.

Get appropriate advice. Trustees cannot know everything, but should be able to identify when they need professional help with an issue. Accessing legal or financial help is particularly important.

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Thomson Snell & Passmore



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Endnotes

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www.gov.uk/government/uploads/system/uploads/attachment_data/file/658766/20171113_Taken_on_Trust_awareness_and_effectiveness_of_charity_trustees.pdf
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 - 13 Charity Times article *Regulator finds against International Tiger Moth Charitable Trust*
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 - 14 Charity Commission case report Oxfam
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 - 15 Charity Commission alert <https://www.gov.uk/government/news/regulatory-alert-to-charities-safeguarding>
 - 16 *Tackling Abuse and Mismanagement* Report of Charity Commission's investigations and compliance work 2012–13
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Other sources of information

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