Community Southwark

Trustee Liability

What is trustee liability?

`Trustee Liabilities are the things that trustees are responsible for in terms of running the organisation in accordance with charity rules.' Charity Commission

It's very important to understand your liabilities when you become a Trustee to make sure the organisation is running well and you are managing risks carefully. In some circumstances trustees become personally liable for debts that the charity cannot meet.

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 role of trustee, you agree to carry out the role properly, in accordance with law and good practice.

If you fall below the minimum standards, 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. The Charity Commission emphasises that it is only likely to enforce personal liability where a trustee has acted dishonestly or recklessly.

Remember to keep liabilities in perspective: very few trustees', who have acted honestly and in accordance with the rules, suffer financial losses as a result of trusteeship.

'Since trustees act collectively in running a charity, they will usually be collectively responsible to meet any such liability.' Charity Commission

Personal Liability:

- Breach of trust under charity law;
- Acting as a charity trustee when disqualified;
- Failure to comply with statutory requirements such as health and safety etc.;
- Failure to deduct an employee's PAYE;
- (In some circumstances) the debts and other liabilities of the organisation.

Breach of Trust includes:

- Spending the charity's money on activities outside of the charity's objects;
- Failure to prudently protect the trust property;
- Carrying out unpermitted political activity;
- Fraud;
- Serious negligence;
- Trustee receiving personal benefit.

Liabilities are likely to arise in two main areas of responsibilities:

- **Operational**: arising from what the organisation does. Example: where the trustee signs a lease for the organisation that fails to pay the rent.

Registered Charity No. 1105835. Company limited by guarantee in England and Wales No. 5090324.

- **Governance:** 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.

Trustee liability depends on what type of charity it is:

Charities can limit their liability by becoming incorporated; this usually means becoming a charitable company, i.e. registering both with the Charity Commission and with Companies House as a Charity Limited by Guarantee. **It is a good idea if the charity is involved in areas which create risks**, for example, signing leases and taking on staff. However the charity **must be sure it has the administrative capacity to comply with the registration requirements.**

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. Trustees’ liability is limited to a token amount, often £1 or £10.

The problems with incorporation include more complex documentation, obligation to comply with rules regarding registration and remaining registered and potential costs of set up and winding up. Incorporation therefore may limit the liability of the trustees as individuals, but it **creates new responsibilities for the organisation – and trustees will be liable if these are unfulfilled**.

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 is particularly true for **operational liabilities**; if the charity is incorporated, then operational liabilities fall on the organisation. If the organisation cannot meet the liability, it may have to be wound up but the trustees are not liable. If the charity is not incorporated and cannot meet its obligations, the trustee is liable.

However **not all risks are covered by incorporation** and trustees may still be liable in:

- **Statutory penalties** and prosecutions e.g. health and safety.
- **Authorised wrongs** i.e. if a trustee authorises another person to act in a way which causes loss or damage to the charity (libel, trespass etc.).
- **Duties in solvency**, i.e. 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.

→ **Learn more:** Charity Commission (CC’s) *Choosing and Preparing a Governing Document* (CC22)
→ **Learn more** about organisational form at NCVO’s *Get Legal* website.

Governance liabilities arise from the Duties of Trustees:

Trustees have certain duties and it’s important to understand these. These duties are the minimum standards that the Charity Commission requires of Trustees to run the organisation properly. By becoming a trustee, you agree to abide by them. It is essential that Trustees protect themselves from risk by understanding duties, and fulfilling them.

There are three main legal duties:

- **Duty of Compliance** – complying with the law of the land, charity law and other relevant laws affecting your organisation.

- **Duty of prudence** - ensuring the charity finances are used appropriately, prudently and lawfully in accordance with the charity's objects
- **Duty of Care** – statutory duty which means trustees must give enough time and energy and use their skills and experience to carry out their duties as trustees.

These duties include:

- **Managing conflicts of interest**: i.e. not participating in decisions where the Trustee has a personal interest at stake.
- **Not accepting personal benefit**, including direct or indirect benefit, very broadly defined. Repayment of actual expenses incurred is acceptable, but all other payments and non-financial benefits should be treated with extreme caution.
- **Following the governing document**: acting only within the charity's objects (stated purposes), and powers (actions authorised within the document). It is not sufficient to act in a way which seems sensible or appropriate, unless this is permitted by the governing document.
- **Safeguarding assets** to ensure they are not lost or devalued, including making decisions with appropriate expertise (e.g. investment decisions). Also to ensure all assets are used only to advance the stated purposes (objects) of the charity.
- **Acting prudently** to ensure the organisation remains solvent and activities do not put the organisation's reputation or assets at risk. Recognising that it is for Trustees, not anyone else, to think through the implications of issues facing the organisation.
- **Acting with care** involves not only using such care as is reasonable in the circumstances, but ensuring decisions are made with appropriate knowledge or skill. Recognise where trustees lack the knowledge to make appropriate decisions, and should seek external advice.
- **Acting collectively** – decisions must be taken by the trustee board together and not be delegated to individuals, unless this is expressly allowed by the governing document.
- **Ensuring restrictions** on funds are observed so that money received for a specific purpose is only used for that purpose. If trustees authorise use of restricted funds for other purposes they may be personally liable

→ **Learn more**: CC's *The Essential Trustee: What you need to know* *(CC3)*
→ **Learn more:** CC's *The Hallmarks of an Effective Charity* (CC10)

Ways for Trustees to mitigate risk from Governance Liabilities:

It is essential to **gain a real understanding of your constitution** and constantly keep it in mind when making decisions. This will help you assess whether the constitution sufficiently protects you or if it needs to be changed. It will also help you to focus on always acting in accordance with the charity's objects and powers. Make sure you understand what your objects and powers allow you to do. If you have any doubts about what it says, seek professional advice. 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.

→ **Learn more:** Charity Commission's *Choosing and Preparing a Governing Document* *(CC22)*

Monitor finances closely to ensure the organisation can fulfil its financial commitments. 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.

→ **Learn more:** CC's *Managing Financial Difficulties and Insolvency in Charities - (CC12)*
→ **Learn more:** CC's *Managing charity assets and resources: an overview for trustees (CC25)*

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.

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.

→ **Learn more:** CC's *Internal Financial Controls for Charities (CC8)*

Be wary of **personal benefit** that's not repayment of expenses

→ **Learn more:** CC's *Trustee expenses and payments (CC11)*

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

→ **Learn more:** CC's *Vicarious liability of a charity or its trustees*

The starting point is a **really effective induction** for new trustees. 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.

Liability for operational risks

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 above).

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.

If the charity is not incorporated and cannot meet its obligations, the trustee is liable

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.

In most cases incorporation, care and insurance are the answers to reducing the risk of personal liability.

Operational Liabilities to staff and volunteers

As soon as an organisation employs staff, the level of risks that it faces goes up substantially, and these duties can change rapidly as employment law changes. 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.

Employment of staff is one of the key indicators of the need for an organisation very seriously to consider incorporating (see above). 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 below), which covers such a claim.

Managing operational liabilities

The key tools for managing organisational liabilities include:

- insurance (see below)
- 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.

→ **Learn more:** CC's *Charities and Risk Management* *(CC26)*

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 **trustee indemnity insurance.**

Insuring a trustee confers a benefit on the trustee, not the organisation. Although this is a personal benefit, it is acceptable in charity law provided the cost is reasonable and trustees are sure it's in the best interests of the charity. In some rare instances, a charity's constitution expressly forbids the purchase of Trustee Indemnity insurance and in this case the charity must approach the Charity Commission for permission to buy Trustee indemnity Insurance.

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 – there will be a wide range of risks it does not cover, 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

For this reason many organisations do not take out trustee indemnity insurance. However 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.

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.

→ **Learn more**: CC's *Charities and Insurance (CC49)*

Resources from the Charity Commission

The Essential Trustee: What you need to know (CC3) – specifically Section I: If Things Go Wrong.
Internal Financial Controls for Charities (CC8)
The Hallmarks of an Effective Charity (CC10)
Trustee expenses and payments (CC11)
Managing Financial Difficulties and Insolvency in Charities (CC12) – specifically Section E: Liability of Trustees
Choosing and Preparing a Governing Document (CC22)
Managing charity assets and resources: an overview for trustees (CC25)
Charities and Risk Management (CC26)
Charities and Insurance (CC49) – specifically sections D and E
Vicarious liability of a charity or its trustees

Other resources

[Code of Good Governance]
[Institute of Chartered Secretaries and Administrators (ICSA)]
[Institute of Leadership & Management (ILM)]
[The Association of Chief Executives of Voluntary Organisations (ACEVO)]
[The Clore Leadership Programme]
[Cranfield Trust (also run HRNet)]
[Small Charities Coalition]

Support

If you would like any support with governance or any other issues facing your organisation, please contact the Development Team at Community Southwark:
development@communitysouthwark.org.uk or 020 7358 7020.