

TURCAN CONNELL

DUTIES OF
TRUSTEES

6th Edition

As a charity trustee or a director of a charitable company in Scotland, you need to know and understand fully your legal obligations, some of which arise under statute and some under common law. You also need clear advice to ensure that your charity is run as effectively as possible.

The Office of the Scottish Charity Regulator (OSCR) has issued clear and accessible guidance on trustees' duties and responsibilities in its publication 'Guidance for Charity Trustees – Acting with Care and Diligence', which combines elements of law and good practice. This Turcan Connell guide to the duties of trustees has been written to focus primarily on your legal obligations.

This guide details the duties of trustees of Scottish charities as at February 2013. For ongoing developments, please visit the charity pages of our website.

CHARITY TRUSTEES

The Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) introduced a definition of 'charity trustees' as "the persons having the general control and management of the administration of a charity". This term therefore extends to all those in charge of charities however constituted and includes, for example, trustees of charitable trusts, directors of charitable companies and those in charge of charities which are unincorporated organisations. The duties also extend to the charity trustees of Scottish Charitable Incorporated Organisations (SCIOs) and some duties extend to the members of SCIOs.

The main duties of charity trustees are as follows. Some arise under the 2005 Act and some under the general law applicable to specific types of charity.

1) GENERAL DUTIES

The 2005 Act imposes the following general duties on you as a charity trustee:

- i. You must seek, in good faith, to ensure that the charity acts in a manner which is consistent with its purposes. (Members of SCIOs are also subject to this duty.)
- ii. You must act with the care and diligence that it is reasonable to expect of a person who is managing the affairs of another person.

- iii. Where there is a potential conflict of interest between the charity and a person who appoints you as a trustee, you must put the interests of the charity before those of the person appointing you. If you are under some other duty which prevents you from doing this, you must disclose this conflict of interest to the charity and must not take part in any deliberations or decisions of the trustees in relation to the matter in question.

In particular, charity trustees are, and have always been, subject to an overriding duty to act in the best interests of the charity.

In addition:

- iv. As a trustee, you must ensure that the charity complies with the 2005 Act.

Any breach of these duties will be treated as misconduct in the administration of the charity, entitling OSCR to invoke its powers under Section 31 of the 2005 Act. These include powers:

- to suspend the trustees
- to direct the charity to cease representing itself as a charity or as a Scottish charity
- to restrict the transactions which may be entered into, or the nature or amount of payments which may be made, in the administration of the charity without OSCR's consent
- to direct any third party holding property on behalf of the charity not to part with it without OSCR's consent.

OSCR is under a general duty to act proportionately in performing its regulatory function and so any action which OSCR may take must be proportionate to the misconduct concerned. OSCR cannot suspend a charity trustee under these powers if it considers the trustee has acted honestly and reasonably in relation to the misconduct and ought fairly to be excused.

Where there has been a breach of any of these duties, the charity trustees

must take whatever steps are reasonably practicable to ensure that the breach of duty is corrected and not repeated, and that any trustee who has been in serious or persistent breach of duty is removed as a trustee. It is unusual for a charitable trust deed to give trustees power to remove one of their number and, in the absence of an express power, the trustees would have to petition the court for the offending trustee to be removed.

In the case of charities which are not trusts, the procedure for removal would depend on the charity's constitution; for example, the removal of a director of a charitable company would be dealt with under the company's Articles of Association and the terms of the Companies Act.

Quite apart from the provisions of the 2005 Act, a breach of the general duties set out at the start of this section could render a trustee personally liable under the general law.

2) DUTY TO IMPLEMENT THE CHARITY'S PURPOSES

As a charity trustee, you must administer the charity in accordance with its purposes. You must familiarise yourself with the terms of the trust deed or other constitutional document and must act in accordance with it in administering the charity.

3) DUTY TO CONTROL THE CHARITY'S PROPERTY

As a charity trustee, you must take steps to establish full details of the charity's property. In addition you

must keep the charity's property under your control. In the case of charitable trusts this means that trust assets must be held in the name of the trustees or of a nominee permitted by the trust deed or by the 2005 Act. The 2005 Act permits trustees of charitable trusts to hold property through nominees when exercising their statutory power of investment under that Act. The power does not apply when exercising powers of investment expressly conferred in the trust deed or other governing document.

Trustees must keep nominee arrangements under review and, if appropriate, consider whether they need to exercise their powers to give directions to the nominee or revoke an appointment. The power to appoint a nominee is subject to any contrary provision in the trust deed or under any legislation.

4) DUTY TO KEEP ACCOUNTS

As a trustee, you have a general duty to keep proper records and accounts of the charity's property. In addition, the Charities Accounts (Scotland) Regulations 2006 (as amended) oblige charity trustees to keep accounting records and to have the accounts independently examined or audited, subject to certain financial thresholds. The accounts must be submitted to OSCR not later than nine months after the end of the charity's financial year. There is further detailed information on Accounting Requirements on page 5 of this guide.

5) DUTY TO DEVOTE TIME TO THE CHARITY'S AFFAIRS

As charity trustees, you must meet together as often as is necessary for the proper administration of the charity and give such time and attention to the charity's affairs as is required for its proper administration and to meet the objective standard of care and diligence in the 2005 Act.

6) DUTY TO INVEST

Charity trustees have a general duty to invest the charity's funds, to the extent that they are not required for carrying out the purposes of the charity. This is mainly relevant to grant-making charities and to charities which hold substantial funds for extended periods.

Trustees of charitable trusts will normally be given express powers of investment in the trust deed. If there are no express powers of investment, or if the powers conferred by the deed are limited, the trustees can rely on the statutory powers of investment contained in the 2005 Act. If the trustees are using the statutory power of investment they must have regard to the suitability to the charity of the proposed investment, and also to the need for diversification of investments of the charity. The charity trustees must also obtain and consider proper advice when exercising the statutory power of investment and when reviewing the trust investments, unless they reasonably conclude that in all the circumstances it is unnecessary or inappropriate to take advice. These requirements can also be taken as

best practice in the case of charities which are not created as trusts.

Charity trustees of other types of charities, such as companies and unincorporated associations, will normally have full powers of investment. Scottish charities are permitted to invest in Common Investment Funds and Common Deposit Funds. Those funds are presently established only in England and Wales but are available for investment UK-wide.

7) DELEGATION OF POWERS

Trustees of charitable trusts are permitted by the 2005 Act to appoint a discretionary investment manager to manage the charity's investments. This is subject to any restriction in the trust deed, or under other legislation. Apart from this, you may not delegate any of your powers or duties as a trustee, unless the constitution permits you to do so. If you do delegate the investment of the charity's funds, you must still continue to monitor and review the manager's performance and to set investment objectives and parameters. You may appoint other agents to carry out certain tasks, such as appointing accountants to prepare accounts and lawyers to prepare documents, but you may not delegate your primary role of overall responsibility for the administration of the charity and for taking decisions.

8) CONFLICTS OF INTEREST

As charity trustees, you should not act in a way that brings you into conflict with the interests of the charity. You must not derive any

personal profit from the charity (although there are statutory provisions permitting remuneration of trustees in certain circumstances), nor should a trustee, as an individual, enter into any transaction with the charity.

9) DUTY TO TAKE ADVICE

Trustees should take advice from a properly qualified person in matters on which they are not themselves expert.

10) DUTY OF DISCLOSURE

Trustees must make available copies of the charity's constitution and most recent set of accounts when asked to do so by any third party. Trustees may make a charge for doing so, but the charge must be limited to the cost of providing the copy requested.

11) DUTY TO OBSERVE THE GENERAL LAW

Charity trustees are subject to the general law and, depending on the activities in which the charity is involved, may be subject to employment law, health and safety legislation, the law of delict, criminal law, human rights legislation and other legal provisions. Charities are also subject to the provisions of the Equality Act 2010 and must not discriminate in the provision of benefits or services. The only permitted exception is where the objects of the charity are intended to protect a particular section of society who share a protected characteristic, and where the obligation is a proportionate means of carrying out a legitimate charitable aim.

The protected characteristics are:-

- Age
- Disability
- Gender reassignment
- Marriage and civil partnership
- Pregnancy and maternity
- Race
- Religion and belief
- Sex
- Sexual orientation

ACCOUNTING REQUIREMENTS

All Scottish charities must keep proper books of account and prepare an annual statement of account along with a report on their activities, the Trustees' Annual Report. The report deals with matters relating to the charity's structure, governance and management, its objectives and activities, and its achievements and performance. In particular, the report must explain the methods adopted for the recruitment and appointment of new trustees. The report must provide details of any external person who is entitled to appoint a trustee along with the policies and procedures adopted for the induction and training of trustees, and the identification and management of risks to which the charity is exposed. Increasingly, OSCR expects to see a statement on the public benefit which the charity has provided through its activities, and it is strongly recommended that charities reflect on and disclose how they have provided or intend to provide public benefit. The charity's reserves policy must also be explained. If a charity's income

is more than £500,000, there are additional matters it must report on, such as social investment policy and trustee remuneration.

The accounts and the report must be audited or independently examined and filed along with the charity's Annual Return to OSCR (not to be confused with the separate Annual Return which charitable companies must submit to Companies House). Accounts and OSCR annual returns can be lodged online. Accounting records must be retained by the charity for at least six years.

The Charities Accounts (Scotland) Regulations 2006 (as amended) provide that charities with a gross income of £250,000 or more should produce fully accrued accounts. For charities with a gross income of less than £250,000, simplified accounts consisting of a receipts and payments account, a statement of balances, notes and an annual report are required.

The Regulations provide that the threshold for audit is a gross income of £500,000 or capital assets with an aggregate value exceeding £3.26 million, unless an audit is required by the charity's constitution, in which case the constitution overrides the Regulations. Otherwise, a more informal independent examination is required. Where the charity's gross income is between £100,000 and £500,000, the level of independent examination is more rigorous than for charities with gross incomes below £100,000, in order to relieve smaller charities of some of the burden of the accounting requirements. In particular, the

level of qualification required of an independent examiner is lower for charities below the £100,000 income level.

Under the Regulations the period for submitting the annual report and accounts to OSCR is nine months after the end of the charity's financial year. The Regulations also apply the principles and methodology of 'Accounting and Reporting by Charities: Statement of Recommended Practice 2015' issued jointly by OSCR and the Charity Commission for England and Wales (also sometimes referred to as the 'Charities SORP' or just the '2015 SORP'). This contains detailed requirements for the trustees' report amongst other technical accounting conventions.

When a charity fails to prepare accounts or to provide copies to a member of the public who has made a request to receive them, OSCR may apply to the court for an order to prevent the charity, and any person engaged in its management or control, from carrying out further specified activities until the failure has been rectified. This does not prevent a charity from making a charge to members of the public who ask to receive a copy of the accounts, although the charge must reflect the cost of producing the copy accounts.

OSCR may appoint a qualified person to prepare accounts if accounts are not filed on time. The charity trustees are personally, jointly and severally liable for OSCR's costs in relation to the appointment and the expenses of the appointed person in preparing the accounts.

Failure to comply with a request by a person appointed to produce accounts by OSCR for information or access to books and records is an offence. If there is no reasonable excuse, a fine not exceeding 'level 3' (currently £1,000) can be levied.

REMUNERATION OF TRUSTEES

The 2005 Act permits charity trustees to be remunerated for services provided to the charity in certain circumstances. This includes the provision of services of acting as a charity trustee and services provided under a contract of employment.

Remuneration may be paid:

- to a trustee who provides services to a charity
- to a service provider connected with a trustee where the charity trustee may benefit from the remuneration paid.

The conditions to be met are as follows:

- The maximum amount of the remuneration must be set out in a written agreement between the service provider and the charity and must be reasonable in the circumstances.
- Before entering into the agreement the charity trustees must satisfy themselves that it is in the interests of the charity for the services to be provided by that provider for that maximum amount.
- There must be fewer than half of the charity trustees who are party to a written agreement for the provision of services to the charity which is still in force; or

are entitled to receive remuneration from the charity's funds in some other way; or are connected with someone in either of these two categories.

- There must be nothing in the charity's governing document which prohibits the service provider from receiving remuneration.

If a charity trustee or a person connected to a charity trustee is remunerated in contravention of these rules, the charity may recover the amount of the remuneration and OSCR can insist on the charity taking proceedings for recovery.

Where there is a provision in the charity's constitution permitting remuneration in force on 15th November 2004, or where there is a Court of Session order or other legislation authorising remuneration of trustees, such remuneration may be paid on the terms specified.

LIABILITY, IMMUNITY AND TRUSTEE INDEMNITY

As a trustee of a charitable trust, you may only act in accordance with the powers conferred on you under the trust deed or the general law. If you act outside of these powers and a loss results to the trust, you may be personally liable.

Trustees may also be liable to beneficiaries for committing breaches of trust. Breaches of trust do not always result in a loss to the trust fund but, if they do, the trustees will normally be personally liable to make good the loss.

In addition, trustees may be liable to third parties. Trustees entering into contracts are personally liable unless they specifically contract for their liability to be limited as trustees. Provided that entering into the contract is a proper exercise of their powers they are entitled to be indemnified out of the trust fund for any costs which they may incur. However, if they are acting beyond their powers, they are in breach of trust and will normally be personally liable for any resultant costs or loss.

They may also be liable to third parties in other ways, such as: in delict if a third party incurs loss or injury as a result of the negligence of the trustees or their employees; under health and safety legislation; under employment law; and under other legal provisions. If the liability arises through the trustees acting in breach of trust they would normally be personally liable.

IMMUNITY

The trust deed may contain an immunity clause in favour of the trustees. An immunity clause defines the limit of the trustees' liability. For example, it may say that the trustees are not liable for any loss unless they were acting negligently or fraudulently. Such an immunity clause cannot completely exempt the trustees from liability.

As the law presently stands it is possible for exemption clauses to protect trustees against any degree of fault other than fraud or gross negligence. A trustee seeking to rely on an exemption clause will find that the courts will interpret it very

strictly. If the clause is ambiguous, the trustee will not be given the benefit of the doubt.

TRUSTEE INDEMNITY INSURANCE

The Public Services Reform (Scotland) Act 2010 amends the 2005 Act and permits trustees of charitable trusts to take out insurance policies to protect against claims for breach of trust and liability to third parties and to pay the premiums from the trust fund, provided the trust deed does not contain a provision to the contrary. A power commonly included in trust deeds allowing trustees to be reimbursed reasonable expenses in the administration of the trust would be sufficient to allow premiums from such policies to be paid from the trust.

Charities may purchase trustee indemnity insurance in order to protect all and not just a minority of the charity trustees. The purchase of trustee indemnity insurance does not breach the rules on remuneration of charity trustees.

RISK REVIEW

It is critical that charity trustees carry out a proper review of the risks which the charity faces. A formal risk review process can be used to develop a register of risks. A register of risks will typically list not only the key risks faced by a charity, and their possible impacts, but also the steps which the charity trustees are taking to mitigate or manage those risks actively. The register may also score risks by impact and likelihood in order to help measure those risks which need the most urgent attention.

Any formal risk review process should be viewed by trustees as more than a one-off exercise. The creation of a risk register is simply the first stage in what should be an ongoing process. The nature of risks faced by a charity will change over time and so will the steps which are required to manage those risks. Annual reviews of risk registers are important and valuable steps, which ought to be undertaken by charity trustees as a matter of course. Auditors will generally expect to see evidence of a formal risk review process having been carried out and may also ask to inspect a charity's risk register. If an auditor believes that risks are not being properly managed or that actual mismanagement has occurred he or she may be under an obligation to whistleblow concerns to OSCR. It is critical that charities act in advance to prevent such a situation from arising.

While trustee indemnity insurance may be one aspect of risk management for charities, a full understanding by the charity trustees of their legal duties and obligations will go a long way towards preparing the charity trustees for liabilities which may arise. The importance of the induction, training and ongoing education of charity trustees, as an integral part of any risk management process, should never be underestimated.

DISQUALIFICATION

It is a criminal offence under the 2005 Act for anyone to act as a charity trustee while disqualified under that Act. A person who is convicted of this

offence is liable for a prison sentence of up to two years, or a fine, or both. The following persons are disqualified from acting as charity trustees:

- any person who has been convicted of an offence involving dishonesty or an offence under the 2005 Act
- an undischarged bankrupt
- any person who has been removed from being concerned in the management or control of a charity under the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 (the legislation which preceded the 2005 Act) or Section 34 of the 2005 Act
- any person who has been removed from the office of charity trustee by an Order made by the Charity Commissioners for England and Wales or the High Court of Justice in England on the grounds of misconduct in the administration of a charity
- any person who is subject to a disqualification undertaking or a disqualification order under the Company Directors Disqualification Act 1986 (or the Company Directors Disqualification (Northern Ireland) Order 2002).

A person who has been convicted of an offence involving dishonesty or an offence under the 2005 Act is not disqualified if the conviction is spent under the Rehabilitation of Offenders Act 1974. A person who is disqualified from acting as a charity trustee may apply to OSCR for the disqualification to be waived.

TURCAN CONNELL

EDINBURGH:
Princes Exchange,
1 Earl Grey Street,
Edinburgh EH3 9EE
0131 228 8111

GLASGOW:
180 St Vincent Street
Glasgow
G2 5SG
0141 441 2111

LONDON:
12 Stanhope Gate,
London
W1K 1AW
020 7491 8811

If you'd like to get in touch, give us a call or email us at enquiries@turcanconnell.com

To find out more, visit us online at turcanconnell.com

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