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The Governance Institute

Certificate in Charity Law and Governance

Discovery Pack

Overview

This discovery pack has been created to give you an in-depth understanding of what is involved in studying for the Certificate in Charity Law and Governance.

The pack is divided into five sections:

- Introduction
- The short syllabus
- Study text sample chapter
- Sample exam paper
- How to register

Introduction
The introduction tells you, at a glance, what the certificate involves. It provides key details such as entry requirements, study mode, content and benefits of the certificate.

The short syllabus
The short syllabus provides more details about the certificate: key features and qualification structure.

Study text sample chapter
We have included part of a chapter from the study text to give you a taster of the subject matter and format of the material that we provide to support your learning.

Sample exam paper
An exam paper adapted from the November 2018 session is included in this pack. This will give you an accurate example of what could be asked in the exam and how it is structured.

How to register
The final section of this pack explains how you can register for the Certificate in Charity Law and Governance.

INTRODUCTION

Certificate in Charity Law and Governance

Strengthen your charity’s mission with good governance practice

Experience/qualifications: No prior qualifications required
Study mode: Self-study
Support: Webinar taught course. We provide textbooks and support resources such as examiner’s reports and past papers. Students are also very welcome at ICSA events
Cost: £1,500, save 50% with an ICSA bursary (see website)
Dates: Register anytime. Exam in June
Web: icsa.org.uk/discoverclg

The impact a charity can have depends on an effective understanding of charity law and governance. Navigating complex legal and regulatory structures and understanding how they relate to effective governance is essential in helping your charity to fulfil its purpose.

This Level 4 qualification provides an introduction to the legal and regulatory framework around charities in England and Wales, and how this affects charities in relation to issues such as governance, sources of income, and stewardship of assets. If you work for a charity in a role such as secretary, board clerk, head of governance, director, or any other administrative role, this qualification will help you understand the legal framework specific to the charity sector to help you ensure your organisation remains compliant while pursuing its aims.

Content
The course requires 200 hours’ study time over nine months. The qualification covers:

- Charity Law
- Structures and Legal Forms
- Compliance and Regulations
- Governance
- Sources of Income
- Stewardship of Funds and Assets

Benefits
You will gain:

- insight into how poor governance and lack of accountability can cause reputational damage and organisational failure;
- detailed knowledge of the Charity Governance Code, and how to apply its principles;
- knowledge of the legal duties required of charity trustees; and
- the skills to help your organisation expertly navigate legal and regulatory requirements and develop solid governance practices.

THE SHORT SYLLABUS

Key features

The ICSA Certificate in Charity Law and Governance:

- is aimed at individuals working in charities (registered and unregistered) in England and Wales and in particular, those working in roles affected by legal regulation and governance issues and those with governance responsibilities.
- is a Level 4 qualification – equivalent to first year undergraduate level
- contains six compulsory modules
- is externally assessed – ICSA will set and mark the assessment
- is assessed once a year in June
- is graded at Pass (P), Merit (M) and Distinction (D) – students whose level of achievement is below Pass will be classified as Fail A, Fail B, Fail C or Fail D, depending on the number of marks achieved.

Prior knowledge, skills and understanding

Students do not need to achieve any other qualifications before registering for an ICSA Level 4 Certificate in Charity Law and Governance qualification. No prior knowledge, skills or understanding are necessary. There are no formal entry requirements and the qualifications are suitable for non-degree holders, although it is recommended to be working in a relevant occupation.

Assessment

The modules within the qualification are externally assessed via one closed-book examination that will cover content from each module. The examination is set and marked by ICSA and the pass mark is 50%. See the *Qualification structure* section for further information.

The examination provides independent assessed evidence of learning. It also enables students to demonstrate the range of transferable skills they have developed throughout their programme of study by requiring them to apply their knowledge in unfamiliar contexts.

Qualification structure

Level 4 Certificate in Charity Law and Governance

This qualification comprises six modules and is assessed via **one** 3-hour (with 15 minutes reading time) closed-book examination which is set and marked by ICSA. Students must pass this paper to be awarded the qualification. The pass mark is 50%.

Module number	Modules	Total hours study time	Description
1	Charity Law	33	The module explores the legal basis of charity law and charity regulation in England and Wales, the core legal elements of what is capable of being 'charitable' under English law and aspects of trust law, charity law and trusteeship. Students will gain a broad understanding of the legal framework within which the law and regulation of charities and charitable activity in England and Wales is set.
2	Structures and Legal Forms	33	This module explores the principle of incorporation and the different legal forms that are available for charities. It outlines group structures and how they work and explains in more detail the legal forms of charitable incorporated organisations and companies limited by guarantee. It also explains the nature of a constitution and its typical content. Students will gain a broad understanding of the advantages and disadvantages of each legal form, the nature of their constitutions, and a more detailed understanding of the law relating to Charitable Incorporated Organisations and companies limited by guarantee.
3	Compliance and Regulation	33	This module explores the regulatory framework for charities and the role of charity regulators across the UK. It explains the requirements for charity registration in England and Wales and criteria for exemptions to registration. Students will gain a broad understanding of the regulatory requirements for charities and charitable companies, and the reporting and accountability obligations in regard to statutory accounts and reports.
4	Governance	67	This module explores the concept of corporate governance, including its history, the current key themes, and its application to charities. It then looks in more detail at the key components of effective governance, including governance processes, boardroom behaviour and the role of the board.

			Students should be able to apply the information learnt to an existing charity, enabling them to take the first steps to review and improve governance.
5	Sources of Income (Generating Resources)	17	The module explores some of the most fundamental and common sources of income for charities (the means by which they generate financial resources). It also explores the most important legal and governance issues relating to those sources and the activities involved in accessing them. Students will gain a broad understanding of the main charity funding sources and their legal and governance implications.
6	Stewardship of Funds and Assets	17	The module explores the key principles of stewardship of charitable funds and assets, including their protection and correct application. It also examines the role of charity trustees as those principally responsible for this stewardship. Students will gain a broad understanding of these key principles and how they affect the trustees as they seek to discharge their principal legal duties and responsibilities in practice.
	Total hours	**200**	

STUDY TEXT
SAMPLE CHAPTER

CHARITY LAW AND GOVERNANCE: A PRACTICAL GUIDE

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The Governance Institute

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Structures and legal forms

Different legal forms

Charitable status is conferred on an organisation because of the reasons why it is set up; it is not a description of a type of legal form or structure. Charities can adopt one of a number of different types of legal form and structure, and we will look at some of the forms most commonly used.

The most common legal forms for charities are:

- trusts;
- unincorporated members' associations;
- registered societies;
- chartered bodies;
- statutory corporations;
- companies limited by guarantee (CLG); and
- charitable incorporated organisations (CIO).

In addition, many charities will have subsidiaries, often for trading. These will usually take the form of either:

- a company limited by shares (CLS);
- a company limited by guarantee (CLG); or
- a community interest company (CIC).

It is sometimes difficult to identify what legal form a charity takes. In many cases it is specified on a charity's letterhead and website. This is a requirement for some legal forms, but does not always happen. If you want to determine a charity's legal form and it is not shown on its letterhead or website, some alternative ways of looking are:

- Read the annual report and accounts for the charity. These should make it clear what type of legal form it is.
- Consider the charity's name. If it has 'Ltd' in the title this implies that it is either a registered society or a company. However, note that charitable companies and registered societies can be exempt from using 'ltd' or 'limited' in their name.

- Look on the Charity Commission's Register of Charities to see the title of the charity's constitution. Different legal forms have different titles for their constitution (see below) and so the title used can indicate its legal form.
- Search for it on the register held by Companies House. This register now includes all incorporated organisations, and not just companies, so it is a useful way of identifying the legal form of many types of organisation.

Table 2.1: Legal forms for charities

	Incorporated?	Members as well as board members	Regulator	Limited Liability
Trust	No	No	Charity Commission	No
Unincorporated members' association	No	Yes	Charity Commission	No
Company limited by guarantee	Yes	Yes	Charity Commission Companies House	Yes
Registered society	Yes	Yes	FCA	Yes
Chartered body	Yes	Yes or no	Charity Commission Privy Council	Yes
Charitable incorporated organisation	Yes	Yes	Charity Commission	Yes
Statutory body	Depends on statute	Depends on statute	Charity Commission	Depends on statute

Incorporation

A key issue with the types of legal form set out above is that some are incorporated, and some are unincorporated. Trusts and unincorporated members' associations are unincorporated organisations. Companies limited by guarantee; registered societies; CIOs, and chartered bodies are corporate organisations.

Incorporation means that an organisation is a corporate entity. This means that it has legal personality (i.e. the law recognises the organisation as a person). An incorporated organisation is seen as existing in its own right and being distinct from the people who control it. This means that an incorporated organisation can enter into contracts; own assets and land; and sue and be sued, all in its own right.

An unincorporated organisation has no separate legal identity or personality. So, the assets of an unincorporated charity are vested in the charity trustees or (in the case of some unincorporated members' associations) the members of the charity. This means that the charity trustees (and in some cases, the members) are personally liable for the debts and liabilities of their charity. If the charity has debts it must pay them. It someone wants to sue the charity, it cannot be sued in its own right as it is not a legal entity; the trustees or the members will be sued. What is more, the trustees of an unincorporated charity are jointly and severally liable. This means that the liability does not need to be shared equally between them all. If an unincorporated charity has 10 trustees, and somebody has a claim against them of £100,000, that person does not need to sue all 10 trustees for £10,000 each. They can sue a smaller number, or even just one trustee, for the full amount.

This liability exists in an unincorporated organisation whether or not the board has acted appropriately. Board members need not have breached their legal duties to be liable. However, if they have acted within their duties they can sometimes be indemnified out of the assets of the charity. Of course, this indemnity will only apply if the charity has the assets available to it. Trustees also have the right to be insured against liabilities, again only if they have sought to act in the interests of the charity (Charities Act 2011, s.189).

Incorporation provides limited liability. So trustees and members of incorporated charities still carry some liabilities, although these are greatly reduced. In a company limited by guarantee, as an incorporated organisation, a member's liability is limited to the amount of that guarantee – usually £1. Trustees' liability is limited to occasions when they have breached their duties; it is for the organisation itself to take action against trustees if these have been breached.

Having legal personality not only impacts on the issue of limited liability, it also has an effect with regard to the ownership of assets, and the question of contracts etc. As an unincorporated organisation cannot hold property, it needs to be held by individuals, on the organisation's behalf. These individuals will usually be the trustees, but it can be held by separate people, sometimes called 'holding' or 'custodian' trustees (Public Trustee Act 1906, s. 4). If the trustees themselves hold the property, every time the trustees changes, the title in the property will need to change. Also, the organisation itself will not be able to enter into contracts; these will need to be entered into by the trustees themselves, as individuals. It is much simpler if the property and contracts can be held in the name of the organisation itself; as they can be in an incorporated organisation (note that the Charities Act 2011 does provide some means of simplification here for unincorporated charities. It states that, for an unincorporated charity, the trustees can pass a resolution allowing two of them to act as signatories for the full trustee body (Charities Act 2011, s. 333)).

History of incorporation

The word 'corporate' derives from the Latin 'corpus', meaning body. The first grants of corporate status came from the crown, which granted the status either by a Royal Charter, or later, by an Act of Parliament. Corporate status was first developed for organisations that we would now describe as not for profit. So the first corporate entities in England and Wales were hospitals, universities and monasteries. A key feature from the start was that the Charter would specify the objects, or purposes, of the body, and it was not allowed to act beyond these. Such acts were deemed 'ultra vires' (i.e. beyond the power) and any ultra vires acts would be void.

By the sixteenth century, Royal Charters began to be granted to trade associations, and it was out of these that the first commercial corporations, which would later lead on to become companies, began to develop.

The development of companies

With the development of the Industrial Revolution, there was a growing desire for a simple means of establishing corporate entities, as it was felt that this would facilitate business activity. In 1844, the Joint Stock Companies Act was passed. This meant that companies could be created without a Royal Charter. Instead, there was a simple registration procedure to incorporate. Potential shareholders could now register a company themselves and were allowed to carry out any activity, as long as it was stated in their constitution, and the registration was approved by the Registrar of Companies. So, for the first time, the use of companies similar to their current form was developed. However, although the company was a separate legal entity, there was no limited liability. This was not available until 1855, when the Limited Liability Act allowed shareholders to limit their liability to the amount that they invested in the company. The Companies Act 1862 was the first Act to be given the title 'Companies Act', the title that has been used since then. This Act also permitted the registration of companies limited by guarantee. Companies limited by guarantee are the form which is used by charities.

Since 1862 there have been a number of Companies Acts, but they have essentially developed along the same themes, with the most recent being the Companies Act 2006.

During the twentieth century, one of the most significant developments was the erosion of the concept of ultra vires for commercial companies. Originally, all companies had to restrict their activities to the purposes, or objects, as set out in their constitution. This principle was gradually eroded over time. However, it is important to note that this erosion and removal of the ultra vires principle does not apply to charitable companies. A charitable company must still act within its objects and it is ultra vires (i.e. beyond its powers) for it to exceed them.

The second key development was the distinction between public and private companies. The Companies Act 1907 recognised that not all companies either wanted, or needed, publicly traded shares. It introduced the distinction between public and private companies. A private company does not offer its shares for sale to the public and its shares are not traded.

The final development was the principle of public disclosure. It is the principle that for the benefit of the veil of incorporation to be conferred there needs to be some transparency in the operations of a company. So, a company needs to make public the names of its board, its shareholders (in a share company) and its performance, via its annual report and accounts. A private company did not have a requirement to disclose its annual accounts until 1967.

Companies are now the most common type of incorporated body within the UK. Chartered bodes still exist and charters are still granted, but this is restricted to professional bodies and, in some rare instances, charities.

Veil of incorporation

The distinction between a company and its members and the fact that they are two different legal persons was established by the House of Lords in 1896.

CASE LAW

The case was *Salomon v Salomon Ltd*, in 1896. This concerned a company which had been set up by Mr Salomon. He had sold his existing business to it for a price of £39,000. At that time, it was a legal requirement that a company had at least seven members. Salomon held a share and his wife, daughter and four sons held the other shares, in trust for Salomon. The price was also paid for the issue of a debenture, secured by a charge, which gave Mr Salomon a priority claim against the company's assets. When the company went into liquidation, the other creditors claimed that 'the company was Mr Salomon in another form' and therefore a claim could be made against him as an individual. They also claimed that the company did not have seven members 'independent and unconnected' with each other. The House of Lords overruled the previous decisions of the High Court and the Court of Appeal and stated 'the company has a legal existence … and it is impossible to deny the validity of the transaction (the purchase of the business and the issue of the debenture) into which it has entered' (per Lord Halsbury LC).

This was a key case, as the highest court recognised the distinction between a company and its members as separate persons. On the face of it, Salomon's sale of the business to the company, which was effectively owned by him alone made no change to the commercial position. Effectively, it was still his business. Yet by separating its legal ownership from himself, he could even become a creditor with priority rights over the assets (against other creditors of the business).

This principle is called 'the veil of incorporation' and it applies to all incorporated bodies. It essentially means that body is separate from the people who set it up, or its members. There are some exceptions and there are some rare times when the courts look behind the veil but essentially the core principle has held to this day.

Limited liability

Limited liability is not complete freedom from liability, it is a limitation of the liability to the amount the shareholder or member has invested or guaranteed. So, with a share company, if a shareholder purchases £100 of shares in the company, and the company goes into liquidation, his liability is limited to that £100. It is part of the assets of the company; these will go towards paying off creditors before being returned to him. But he will never be liable for any more. If a company has debts, limited liability means that those shareholders are not responsible for those debts. They can walk away from them. It is the same with a company limited by guarantee. The member's liability is limited to his guarantee, usually £1.

Share companies are principally about investment – shareholders put their money into a company in the form of shares, hoping that the value of the company will grow, and their share of the company will be worth more. They can also take advantage of the profits of a share company, taking dividends on those profits. Guarantee companies do not pay dividends, and the value of the guarantee does not increase. This type of company is more suitable for groups of people coming together to achieve a particular aim, rather than seeking to profit themselves.

People often think that the term limited liability refers primarily to the directors of a company, but actually it concerns the members in the first instance because it concerns the separation of the company from its owners. The reason why the term is also used for directors (also the trustees in a charitable company) is because it also refers to the fact the company is a separate legal entity, different from those who own it or manage it; it is the company that has action taken against it. So the trustees of an incorporated body are no longer personally liable. However, it is important to understand that, regardless of the legal form that a charity takes, charity trustees can still be liable if they breach their duties. If they do this, action can be taken against them by the charity itself; their fellow trustees; the Charity Commission or the Attorney General acting on behalf of the charity. Such actions are very rare, but trustees do need to remember that limited liability does not relieve them of their duties as trustees and directors.

CASE EXAMPLE

Stampton Arts Association and Stampton Sports are both small registered charities, located in Stampton village in Essex. They both have an income of £7,500 per year. Both of them have charitable objects that restrict them to Stampton. Stampton Arts Association is an unincorporated members association. Stampton Sports is a charitable company limited by guarantee. Neither charity holds any insurance. They both share the ownership of a small hall. The Arts Association uses it for putting on events; Stampton Sports uses it for sports. The hall is very well maintained and both charities take its security very seriously. It is kept securely locked and has a caretaker. However on one occasion, due to illness, the caretaker left the hall unlocked for a short while. A child trespassed into the hall and was injured by falling down its stairs. The child's parents now want to sue both charities. Neither set of trustees has breached their duties in regard to this incident, but there will be a difference in their liabilities. As it is incorporated, the legal action is taken against Stampton Sports itself and its trustees have no liabilities. As it is unincorporated, legal action in regard to Stampton Arts Association is taken against its trustees as individuals. One of its trustees is known locally to be quite wealthy, so the parents choose to sue that trustee, and that trustee alone, for the full damages.

Trustees in an incorporated charity can also be personally liable in the following limited circumstances:

Wrongful or fraudulent trading

Both of these types of liability arise under insolvency law, and therefore apply to charitable companies. They only apply when the company has gone into insolvent liquidation. Wrongful trading occurs when a director knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation, yet allowed the company to continue to trade. Declarations of wrongful trading are quite rare and will not be made if the director took every step they could to minimise the potential loss to the creditors.

Fraudulent trading is similar, but occurs when a director allows the company to carry on, with the intention of defrauding creditors or for any fraudulent purpose. It is much stronger than wrongful trading, therefore it carries stronger penalties. It requires 'actual dishonesty involving … real moral blame'.

In both situations the trustee/director could be held liable for the debts of the company. Directors who are liable for wrongful trading or fraudulent trading can be ordered to contribute to the assets of the insolvent company and are potentially disqualified from acting as a director.

Criminal acts or breaches of statutory duty

In a charitable company it is the company and not individual trustees that is generally responsible and liable for criminal acts or breaches of statutory duty. However, there are some limited situations where the individual trustees could be held personally liable:

- failure to operate PAYE;
- failure to comply with some statutory requirements in relation to legislation such as the Health and Safety, Trade Descriptions and Pensions Acts. These liabilities will usually only arise if the offence has been committed with their 'consent or connivance (or is attributable to their) neglect';
- corporate manslaughter;
- failure to comply with most Companies Acts requirements (i.e. submission of accounts); and
- failure to comply with some Charities Act requirements.

It is possible to apply to the court for relief from personal liability in these situations.

Acting whilst disqualified

A person who serves as a trustee whilst disqualified from doing so may be held liable for all the charity's debts incurred whilst they were a trustee. Acting as a company director or charity trustee whilst disqualified is also a criminal offence and, in the case of acting as a charity trustee, can carry a sentence of up to two years' imprisonment.

Other ways of dealing with liabilities

If an organisation is unincorporated, the trustees will not have limited liability. However there are other ways that their liabilities can be dealt with.

Trustee indemnity insurance

Section 189 of the Charities Act 2011 permits the purchase of trustee indemnity insurance (TII) without explicit authorisation being required in the constitution. Many charities now make use of such insurance. However, the Act does state that such insurance must exclude:

(a) any liability to pay a criminal fine, or a penalty for non-compliance with a regulatory requirement;
(b) any liability for defending criminal proceedings in which the trustee is convicted of an offence arising out of any fraud or dishonesty, or wilful or reckless misconduct; or
(c) any liability that arises out of any conduct which the trustee knew (or must reasonably be assumed to have known) was not in the interests of the charity, or did not care whether or not it was in the best interests of the charity.

These are wide exclusions and they potentially make TII not very worthwhile, particularly for trustees of incorporated charities.

Charity Commission relief

Section 191 of the Charities Act 2011 currently states that if a trustee is, or may be, personally liable for a breach of trust or breach of duty but 'has acted honestly and reasonably and ought fairly to be excused for the breach of trust or duty' the Commission may make an order relieving the trustee wholly or partly from any such liability.

Incorporation of trustees

Under section 251 of the Charities Act 2006, the Charity Commissioner also has the power to grant incorporation for trustees. It can grant a certificate of incorporation to the trustees of a charity. The trustees then become a body corporate. However, this form of incorporation only applies to the trustees of the organisation, not the organisation itself. It also does not confer limited liability.

Types of legal forms

Charitable trusts

A charitable trust is a very simple form of organisation. It is formed when someone gives money or property to another person, trusting them to use it for a specified charitable purpose. (You can also have non-charitable trusts, set up in a similar way, but for a non-charitable purpose such as providing income for your own children.) Trusts are usually established by a trust deed; however, as they are so simple, they can even be set up verbally.

Trusts are one of the more traditional ways in which charities were set up, although they are less commonly used today. However, they are still used by some as their form is so simple and they are often considered ideal for grant giving charities or small charities where the trustees will not face significant potential personal liability. The difficulty is that these charities often grow. As a trust is unincorporated, it is a much less suitable form if a charity wants to own assets, employ staff or enter into contracts. If a charity has been set up as a trust and it later wants to incorporate, it will need to change its legal form.

Advantages

- Quick and easy to set up.
- Less regulated than many incorporated bodies (as only regulated by the Charity Commission).
- No need for a two-tier structure (i.e. no need for both members and trustees).
- Appears to many to be the traditional form for a charity, and therefore suited to a charity (although there is no reason why the other legal forms are not just as suitable).

Disadvantages

- It is an unincorporated form, therefore it has no legal personality and the trustees are jointly and severally personally liable for the debts and other liabilities of the trust. If the charitable trust suffers a loss or faces debts, the trustees' personal assets are at risk. Any legal action will be taken against the trustees, not the trust.
- There is less of a body of law to support their operation. Legal forms such as companies have extensive legislation, such as the Companies Act 2006, that can be relied upon for clarity on how the charity operates.
- VAT grouping is not available for unincorporated organisations.

Unincorporated members' association

This is another type of unincorporated body. It is created when a group of people come together with a shared aim, without a profit motive. Like a trust, it is a simple form. Typically, a group will come together with a common purpose (e.g. to start a local theatre group). It may operate for a while with no written constitution and then one will be adopted. Sometimes this will be because it wants something written down (e.g. who the core management committee will be, or how they are appointed). However, often a constitution is adopted because the organisation is seeking a grant. Having a constitution will often be a requirement of that grant application.

There is no legislation supporting unincorporated members' associations. The closest thing to a legal framework is that the constitution can sometimes be regarded as a contract between the members. Typically, an unincorporated members' association will have a broader membership and then a management committee, who are the trustees if it is a charity. So, an unincorporated members association (e.g. the friends group for a primary school) could have all of the parents as its members; they then elect a management committee each year.

Advantages

- Quick and easy to set up.
- Less regulated than many incorporated bodies (as only regulated by the Charity Commission if they are a charity).
- Allows a new organisation to grow and develop itself organically. They can operate fairly informally. For this reason, unincorporated members' associations are one of the most common forms of small charity. Many charities begin to operate in this way, and then seek to incorporate at a later stage.
- They provide a form that enables there to be a wider membership, thereby allowing a wider stakeholder group to be involved in the charity.

Disadvantages

- They are unincorporated therefore they have no legal personality. The trustees are jointly and severally personally liable for the debts and other liabilities. If the unincorporated members' association suffers a loss or faces debts the trustees' personal assets are at risk. In addition, legal actions will be taken against the trustees and not the unincorporated members' association.
- There is less of a body of law to support their operation. Legal forms such as companies have extensive legislation, such as the Companies Act 2006, that can be relied upon for clarity on how the charity operates.
- VAT grouping is not available.

Chartered body

As set out above, chartered status is the oldest way of conferring incorporation on an organisation in England and Wales. It was the form of incorporation available before registered companies and it pre-dates that form. Although they can technically be described as companies, chartered bodies are not governed by the Companies Act. At one time this was the only way of gaining incorporation, but it has now been overtaken by the registration of companies. Chartered status is conferred on an organisation by the Privy Council. It is less common for chartered status to be granted now, and the right to become a chartered body is generally restricted to professional bodies (which may or may not be charities) or (in rarer cases) some charities. There are quite strict criteria for becoming a chartered body. A professional body will need to show that it is of sufficient size; financially sound; and that it represents a unique field of activity. It will also need to demonstrate how the regulation of its profession will be in the public benefit. Chartered bodies are generally professional bodies; but there are also some chartered charities, such as the British Red Cross.

Advantages

- Incorporated status, without the need for full dual regulation. Chartered bodies are regulated by Privy Council (as well as the Charity Commission if they are charities) but that regulation is effectively restricted to the requirement for Privy Council approval for changes to the charter and byelaws.
- Status. A Royal Charter can be seen to confer authority and respectability onto an organisation.

Disadvantages

- It is very difficult to obtain chartered status. Whilst it is granted to charities in rare circumstances, it is usually only available to professional bodies that meet the criteria.

- Privy Council approval is also required for any changes to the charter and any byelaws, and this can add to the administration and time for changes to be made.
- There is less clarity regarding the law supporting chartered bodies. Whilst the duties of board members are equivalent to the duties of company directors, this is only supported by common law rather than legislation.

Statutory charities

There are a small number of charities which are established by Acts of Parliament, known as statutory charities. Whilst these are established by the government they must still fulfil all of the requirements of independence for a charity. Charities established in this way include NHS charities (i.e. bodies that hold charitable funds associated with NHS hospitals and services) and a range of other bodies, such as the National Trust. The governance arrangements for such charities and whether or not they are incorporated will depend on the individual circumstances and the Acts of Parliament or orders that govern them. Being established by an Act of Parliament is rare; this is not an option for an organisation seeking to establish itself as a charity. In addition, charities set up in this way are usually very limited in their options re legal form; they will not necessarily have the option of changing legal form. For this reason, we have not chosen to list the advantages and disadvantages of being such a charity. However one key disadvantage is that it is often very difficult to amend the constitution of these charities as it requires a new Act of Parliament. Sometimes, the constitution can be added to via a Charity Commission Scheme, and this process can also be used to amend the constitution. So, in the case of the National Trust, a Charity Commission Scheme setting out the details of this constitution became enshrined in an Order, the Charities (National Trust) Order 2005. However, it is also quite common for statutory charities to have quite short constitutions, containing only the most basic requirements. Statutory charities can be either incorporated or unincorporated, depending on the statute that establishes them. For example, NHS charities are unincorporated.

Registered societies

These types of society were previously referred to as Industrial and Provident Societies (IPSs). This legal form provides incorporated status, and has been available for nearly as long as companies. They were first created in the nineteenth century, and the primary legislation was the Industrial and Provident Societies Partnership Act 1852 and Industrial and Provident Societies Act 1893. Before 2014, the primary piece of modern legislation was the Co-operative and Community Benefit Societies and Credit Unions Act 1965. (To add to the confusion with regard to these societies, key pieces of legislation have been renamed: the Co-operative and Community Benefit Societies and Credit Unions Act 1965 was originally the Industrial and Provident Societies Act 1965; it was renamed in 2010.)

Following the Co-operative and Community Benefit Societies Act 2014, there are two types of registered society – community benefit societies and co-operative societies. Community benefit societies are set up to benefit the community as a whole; co-operative societies are set up to benefit their members. As co-operatives are established for the benefit of their members rather than for the public benefit, they are not usually charitable so they shall not be considered here.

Just like companies, registered societies are incorporated bodies and the personal liability of their members and board members is limited. Like a company, they have a two-tier structure, with shareholders and a board of directors. Registered societies have shareholders rather than guarantee members; shareholders each purchase a share in the society as they would in a shareholding company. However, unlike a share company, those shares are not traded and shareholders are not entitled to a dividend.

Although they provide a means of obtaining incorporated status, registered societies are not commonly found outside the social housing sector. They can be more expensive and complex to set up than a company and are not as well understood.

Registered societies are registered with the Financial Conduct Services Authority (FCA), which regulates them, rather than the Registrar of Companies.

For many years these societies operated under quite archaic laws. The Co-operative and Community Benefit Societies and Credit Unions Act 2010 (the 2010 Act) was enacted following a review of Industrial and Provident Societies by HM Treasury. The intention was to update the governance of the societies, and bring them more in line with other corporate forms. A key feature of the 2010 Act was to give HM Treasury the power to make regulations which apply company law to IPSs.

The Cooperative and Community Benefit Societies Act 2014:

- replaced the 'industrial and provident society' legal form with two new legal forms – community benefit society and co-operative society; and
- consolidated previous industrial and provident society legislation.

Before the Act came into force, all societies registered in this way were legally referred to as 'Industrial and Provident Societies'. Now, pre-existing societies are referred to as 'registered societies'. Any new societies are referred to as co-operative societies or community benefit societies. A community benefit society can, but need not be, charitable. For ease we have used the term 'registered societies' throughout this chapter.

Advantages

- They provide a means of incorporation that is specifically designed for non-commercial entities.
- They provide a form that enables there to be a wider membership (via shareholding) thereby allowing a wider stakeholder group to be involved in the charity.

- Registered societies were previously exempt from registration with the Charity Commission, so this provided a means of incorporation that did not require dual registration. However, the legal position in regard to exempt charities is changing and many registered societies may now need to register with the Charity Commission in future.

Disadvantages

- Registration as a registered society is more complex than registration as a company.
- This is a legal form that is less well understood. When entering into agreements and contracts this can have an impact, as the bodies that you are working with will have a less clear idea of how you are established, and whether you are incorporated.
- Some of the regulatory requirements for registered societies are a bit more involved than for companies, and quite arcane. So, for example, if the rules are amended, they need to be signed by three shareholders and the application to register the change must then be signed as a statutory declaration by an officer, before a solicitor or notary public.
- Registered societies are still exempt from registration with the Charity Commission. Whilst this may seem like an advantage, it is also arguably a disadvantage. It means that charitable registered societies do not have a Charity Commission registration number which indicates that they are charitable. Also, they need to establish their charitable nature via applications to HMRC rather than the Charity Commission. This can make it more difficult to indicate to third parties, including potential funders, that you are a charity.
- Unlike charitable companies, registered societies are not exempt from using 'Limited' or 'Ltd' in their name.

Company limited by guarantee

We have discussed companies above, in the context of the development of incorporation. Companies are the form of incorporation that people are most familiar with; whilst they tend to be associated with commercial organisations, they can also be charitable.

Registered companies are established under the Companies Act 2006. When a company is created, the legal form essentially creates a separation between the owners of the company (shareholders or members), and those who run the company, its board. A company has a separate legal personality, distinct from those who set it up. If it fails, they can then walk away from it, and do not have any liabilities (with certain exceptions). As a balance to this benefit, companies have certain requirements regarding transparency and reporting. They must prepare accounts and make them available to members; they have to be open about who their board members are; and they must file this and other information at Companies House.

There are two types of company: a company limited by shares; and a company limited by guarantee. The latter form is the more usual one within the voluntary sector; it is not possible to register a charitable company limited by shares with the Charity Commission, with very rare exceptions.

Any company has to have at least one member (the shareholders or guarantors) and at least one director. These are two separate roles. The same people may carry out both roles; it is quite common for directors to also act as members, but they are still separate and distinct roles.

Under company law, members have distinct rights. They amend the Articles (Companies Act 2006, s. 21) and have the statutory right to remove directors (Companies Act 2006, s.168) and to require the directors to call a general meeting (s. 303). It is also common for the Articles to provide that members have a right to appoint directors.

Companies are regulated by Companies House and are required to submit annual confirmation statements; annual accounts; and to file certain information. They are governed by the Companies Act 2006 and also have legal requirements regarding the records and registers that they keep.

CASE EXAMPLE

Stampton Sports is a charitable company limited by guarantee. It has a board of 12 trustees, who are therefore also its company directors. When it was first established, the trustees were the only members of the company but it has recently decided to widen its membership. Now any member of the local community who applies for membership and guarantees £1 can become a member of the company. The Articles provide that the members elect trustees onto the board.

Advantages

- A company is incorporated and so it provides the protection of an incorporated form. As an incorporated body, it is a legal entity in its own right; it is the company that enters into contracts, owns property; sues and is sued and not the trustees (who are its directors). The trustees and the members have limited liability.
- Companies are very quick and easy to set up. A company can be set up in one day, if necessary. Once set up, if the charitable company has an income of more than £5,000 it will then need to register with the Charity Commission and this will take time. However, the charitable company will exist from the date it was set up as a company, and will be charitable from that date, if the Articles have been drafted correctly.

- Although it carries additional regulation by Companies House, this is fairly minimal.
- It is a legal form that is very familiar to many people. This means that in entering into contracts and agreements, the other parties will be familiar with the legal form of your charity.
- There is a detailed body of company law, both statutes and common law, that sets out how you operate, and that provides a good reference.

Disadvantages

- Charitable companies are subject to dual regulation – they are registered with both the Charity Commission and Companies House.
- For some people, the fact of being a company, which is more usually a commercial form, does not sit easily with being a charity.

Companies are governed by the Companies Act 2006. This is a very detailed piece of legislation, which draws together much of the previous legislation and common law on companies. It sets out how companies should be formed and constituted; the regulatory requirements; how they are wound up and the role and duties of company directors.

The trustees of a charitable company will also be its company directors. Whilst their duties as charity trustees are established in common law their duties as company directors are set out in the Companies Act 2006. Actually, the two sets of duties are, in many ways, very similar. In practice, trustees of a charitable company who are meeting their duties will also be meeting their duties as company directors.

Duties of a company director

The duties are set out in sections 171–177 of the Act

- To act within the powers. This duty means that a director must comply with company law and the company's Articles. They can exercise the powers only for the reasons for which they were given.
- To promote the success of the company. This is one of the few occasions when the Companies Act makes a difference for charitable companies. For commercial companies the Act says that promoting the success of the company is acting 'for the benefit of its members as a whole. It then goes on to say that if the 'purposes of the company consist of or include purposes other than the benefit of its members … promoting the success of the company [is] achieving those purposes' (s. 172). So in a commercial company, the directors must work for the benefit of the members; in a charitable company, they must work to achieve the charitable objects.

- To exercise independent judgment.
- To exercise reasonable care, skill and diligence. As with the common law charity trustee duties, this means applying the level of care, skill and expertise that the director as an individual would be expected to have. If they have specific skills (e.g. as an accountant) they are expected to apply them.
- To avoid conflicts of interest.
- Not to accept benefits from third parties.
- To declare interests in proposed transactions or arrangements.

Charitable incorporated organisation

The charitable incorporated organisation (CIO) is a legal form specifically designed for charities, so if your organisation is a CIO, it must be a charity. CIOs were created by the Charities Act 2006, but did not come into existence for some time after that. In Scotland, CIOs started in 2011. England and Wales had to wait a bit longer – the first CIOs were registered in 2013. The purpose of the CIO was to give charities an incorporated legal form, without the need for dual regulation. As you can see from Table 2.1, for nearly all the incorporated legal forms other than a CIO, there is another regulator as well as the Charity Commission. For CIOs, the Charity Commission is the sole regulator.

A CIO is incorporated, like a company, so the trustees have limited liability. As an incorporated body it can hold assets, employ staff, enter into contracts, sue and be sued, in its own right. Like a company, it has to have members as well as a board (the trustees), although it can have just one member. CIOs take two different forms – an association CIO, which has a body of members who are distinct from the trustees; or a foundation CIO, where the members and the trustees are one and the same people.

Being a CIO can seem like a simpler way of being incorporated without having to become a company. However, it should be remembered that there are a number of advantages in being a charitable company. It is actually simpler and quicker to set up a company; what then takes more time is registration with the Charity Commission. In addition, it is arguable that being a company is a more widely recognised legal form. This can give a number of advantages in contracting and working with third parties. It also means that there is an established body of law behind the legal form.

One of the real advantages of a CIO as a form is for smaller charities. At the present time, charity registration is not an option for charities with an income below £5,000 each year unless they are a CIO. The Charity Commission just does not have the resources to offer registration to smaller charities. Although registration with the Charity Commission carries obligations regarding annual returns and filing of accounts these are not onerous and there are a number of real advantages with being a registered charity. It clearly shows that an organisation is a charity and gives security to funders and donors. Charities with a registration number can find that it helps them to fundraise. If a small charity wants to be registered with the Charity Commission, becoming a CIO is a way of becoming registered without having to meet the income requirements.

Advantages

- Charitable incorporated organisations are incorporated, so it provides the protection of an incorporated form. As an incorporated body, it is a legal entity in its own right; it is the company that enters into contracts, owns property; sues and is sued and not the trustees (who are its directors). The trustees and the members have limited liability.
- Charitable incorporated organisations are regulated only by the Charity Commission.
- They give a means by which smaller charities with income below £5,000 can be registered with the Charity Commission.
- It is a form designed specifically for charities.

Disadvantages

- It is a legal form that is not familiar to many people. When entering into agreements and contracts this can have an impact, as the bodies that you are working with will have a less clear idea of how you are established, and whether you are incorporated.
- It is a new form of legal entity and the body of law to support its operation is not as established as other forms (e.g. companies).
- It is slower and more complex to set up than a company. Establishing it as a body is tied in with registering it with the Charity Commission. This means that much needs to be resolved at an early stage (e.g. setting up a bank account) and this can be difficult.

Group structures

Some charities are very simple and all of their activities are carried out by one legal entity, the charity itself. However it is also common for charities to have some form of group structure. Many charities will have a trading subsidiary, and some will have a number of different subsidiaries, for a number of different reasons and purposes.

- There are a number of reasons why group structures emerge:
- The restrictions on trading for charities means that many charities will have a trading subsidiary.
- Subsidiaries are sometimes created due to tax or VAT considerations.

- Sometimes there is a need or desire to separate out governance of particular activities (e.g. a housing association which also provides care homes may want to have a separate board with particular expertise running that part of its work).
- Having a subsidiary is sometimes seen as a way of managing risk. As the subsidiary is a separate legal entity the parent charity will not be liable for any losses. Although it will 'own' the subsidiary, usually as the sole shareholder, limited liability will apply. However, this risk management has its limitations. The subsidiary will usually share the same branding as the charity, and so its insolvency could be a significant reputational risk for the charity.
- A need for separate identities. For example, charities that have merged will sometimes still operate as separate legal entities within the same group, keeping their previous names and identities but sharing resources.

The definition of a group is set out in section 474 of the Companies Act 2006 as 'a parent undertaking and its subsidiary undertakings'. Whilst this definition comes from the Companies Act, note that neither the parent, nor the subsidiaries need to be companies, they just need to be undertakings. The significant feature of a parent/subsidiary relationship is one of control. Section 1162 of the same Act gives a more complete explanation:

> An undertaking is a parent undertaking in relation to another undertaking, a subsidiary undertaking, if—
> (a) it holds a majority of the voting rights in the undertaking, or
> (b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors, or
> (c) it has the right to exercise a dominant influence over the undertaking—
>   (i) by virtue of provisions contained in the undertaking's Articles, or
>   (ii) by virtue of a control contract, or
> (d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

Trading subsidiaries are the most common type of subsidiary. A charity should usually only carry on trading activities which are either directly in pursuance of its objects or which are ancillary to their objects (together known as primary-purpose trading). The amount of other non-primary-purpose trading they can carry on is strictly limited. Charities who want to carry out non-primary-purpose trading, beyond these limits will probably need to do this via a trading subsidiary established as a separate company.

A trading subsidiary is usually a company limited by shares, with the charity as the sole shareholder. This then gives the charity complete control over appointments to the subsidiary board. The trading subsidiary will usually Gift Aid its taxable profits to the charity. Any profits transferred in this way will therefore be free from corporation tax. It is important for the subsidiary to remember that it should not necessarily transfer all of its profits in this way. It will usually need to retain some of its profits for working capital and investment in future work, and these profits will therefore still be liable to corporation tax. The donation to the parent charity needs to be paid over to the charity within nine months of the trading company's year end, in order to obtain tax relief for the financial year in question.

A charity's assets can only be used for charitable purposes; they cannot be used to support a non-charitable subsidiary. A charity can invest in its trading subsidiary, but only if:

- it can show evidence that the investment by way of loan funding was made to benefit the charity;
- there are terms and conditions for repayment (including interest);
- the charity gets a fair return that is paid to it; and
- the charity and its trustees comply with applicable charity investment rules and requirements.

The need to protect the charitable assets of the charity also means that the trading subsidiary must be kept separate from the charity; the relationship between the two must be kept at arm's length. A key feature of this is that whilst it is common for charity trustees also to be directors of its trading subsidiary, there can be conflicts of interest. In the interests of good governance, it is recommended that there should be at least one person who is a charity trustee, but not a director or employee of the trading subsidiary; and at least one person who is a director of the trading subsidiary, but not a charity trustee or employee of the charity.

A charity with a trading subsidiary should also ensure that:

(a) the charity and its trading subsidiary should have separate bank accounts – there should be no mixing of funds;
(b) there is no subsidy in the form of income, staff time or the use of shared facilities, interest-free loans, or the guaranteeing of loans – the charity should make a management charge for the use of any shared resources; and
(c) it is advisable to have an intra-company agreement between the two companies and/or some form of service level agreement.

We have talked above about the simplest type of group structure, a charitable parent organisation with one subsidiary, usually a trading subsidiary. However, group structures can be much more complex than this. Some key things to remember are:

- a parent organisation can have a number of subsidiaries. Not all will be non-charitable – it may have some charitable subsidiaries and some non-charitable subsidiaries;
- a subsidiary can itself have a subsidiary. There can be more than one tier in a group structure;

SAMPLE
EXAM PAPER

The Governance Institute

Charity Law and Governance

Adapted from the November 2018 exam paper

Time allowed: 3 hours (plus 15 minutes reading time)

Section A

*Answer **all** the questions in this section.*
Continue your answers on the continuation sheets at the back of the booklet, if necessary.

1. If a charity needs to complete a Charity Commission annual return, how long, after its financial year end, does it have to complete and file this return?

(1 mark)

2. What are the legal penalties faced by a person who acts as a charity trustee of a charitable company whilst legally disqualified from doing so?

(2 marks)

3. The Charity Commission is accountable to Parliament.

Is this **true** or **false**?
*(Tick **one** box only)*
☐ True
☐ False

(1 mark)

4. Describe some of the common mechanisms for providing monitoring information to boards.

(4 marks)

5. Which Act specifies the legal rules on 'Standard Investment Criteria'?

(1 mark)

6. State **two** alternative names for the constitution of an unincorporated charitable trust.

(2 marks)

7. Which of the following types of payment is **not** usually regarded as being a benefit to a trustee?

*(Tick **one** box only)*
A ☐ Payment of an 'honoraria'.
B ☐ Payment to a business owned by the trustee.
C ☐ Payment of reasonable expenses.
D ☐ Payment to a trustee for being a director of the charity's trading subsidiary.

(1 mark)

8. Outline the legal parameters for charities being able to trade lawfully.

(4 marks)

9. Identify **two** methods of board appraisal.

(2 marks)

10. Give **two** elements of the 'benefit' requirement in the legal obligation for charitable purposes to be for public benefit.

(2 marks)

TOTAL FOR SECTION A = 20 MARKS

Section B

*Answer **all** the questions in this section.*
Continue your answers on the continuation sheets at the back of the booklet, if necessary.

11. Outline the key features of the 'Code of Fundraising Practice'.

(5 marks)

12. Explain the legal concept of 'limited liability' in a company.

(6 marks)

13. Explain some of the advantages of using a governance code to set out the standards and principles of corporate governance, with reference to a code regularly used in England and Wales.

(6 marks)

14. Explain the reasons why a charity might establish a group structure.

(6 marks)

15. Explain how voting is usually conducted at a general meeting.

(6 marks)

16. Describe the legal requirements applicable under section 117 of the Charities Act 2011 when a charity proposes to sell land to an independent third party.

(6 marks)

TOTAL FOR SECTION B = 35 MARKS

Section C

*Answer **all** the questions in this section.*
Continue your answers on the continuation sheets at the back of the booklet, if necessary.

17. You are the charity secretary of ABC Charitable Trust, an unincorporated registered charity. New trustees will be appointed to the board shortly. The Chairman wants a briefing note for the newcomers explaining their general legal duties as charity trustees.

    Prepare a briefing note for the new trustees, advising them on their general legal duties.

(15 marks)

18. "Events in the charity sector over the last few years have continued to demonstrate the importance of good governance" (Charity Commission; Tackling Abuse and Mismanagement 2016/17).

    Discuss the key elements of good governance in a charity **and** how events since 2015 have impacted on our understanding of this.

(15 marks)

19. Haverton Sports Fields is a small charitable company that was established in 2001. It manages a sports field in the village of Haverton. It has a board of 10 trustees, 100 members, and a larger group of supporters who are also invited to its general meetings, as observers. It is registered with the Charity Commission, and has an annual income of approximately £15,000 each year.

    Over the last year there has been much dissent amongst the members and supporters about the proposed use of the sports field and this has led to more information requests from members and supporters. Jo was appointed as Honorary Secretary in March 2018 and has sought your advice on a number of information requests that she has received:

    i. A member of the charity has requested a copy of the 2010 AGM minutes but the charity has a policy of only retaining AGM minutes for 6 years.

    ii. Another member has requested a copy of the 2015 AGM minutes. The minutes are kept on Microsoft Word and there are two different versions. She is uncertain which version to use.

    iii. The minutes of the 2016 and 2017 AGMs were signed by the Chair of the meeting and Jo has hard copies. However, a member is disputing the accuracy of the 2016 minutes, and claims to have detailed notes of the meeting to support the claim. The member wants the minutes to be reviewed at the next AGM.

    iv. The board usually publishes its board minutes on its website. Because of the dispute with the members, the last two sets of board minutes have not yet been published. A member is now demanding to see these minutes.

    v. Jo has also informed you that a supporter had requested a copy of the last annual report and accounts (the financial year ended on 31 December 2017). She has already informed the supporter that as the charity has income below £25,000, it is not required to prepare annual reports and accounts.

    Prepare advice for Jo on these matters, and on the legal requirements in regard to minutes and annual reports and accounts.

(15 marks)

TOTAL FOR SECTION C = 45 MARKS

TOTAL FOR PAPER = 100 MARKS

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We hope this discovery pack has given you a good understanding of what studying the Certificate in Charity Governance involves.

If you would like more information, or want to talk to someone about your options, contact our Student Services Team on studentsupport@icsa.org.uk or +44 (0)20 7580 4741.

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