



The Governance  
Institute

# Charity Law and Governance

**Mark scheme**

November 2017

# Section A

Question number	Answer	Mark
1	<p>Any two of the following up to two marks:</p> <ul style="list-style-type: none"> <li>Chartered body</li> <li>Limited company (guarantee or shares. An answer that just refers to “company” is acceptable, but a maximum of one mark can be given even if different types of company are listed.)</li> <li>Registered society</li> <li>CIO</li> <li>LLP</li> </ul> <p><b>Reward other valid responses.</b></p>	(2)

Question number	Answer	Mark
2	<p>Any two of the following up to two marks:</p> <ul style="list-style-type: none"> <li>National Housing Federation (NHF) Code of Governance</li> <li>NHS Foundation Trust Code of Governance</li> <li>Corporate governance in central government departments</li> <li>UK Corporate Governance Code</li> </ul> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: The wording used does not need to be completely accurate, provided it is clear which Code is being referred to.</b></p>	(2)

Question number	Answer	Mark
3	True	(1)

Question number	Answer	Mark
4	<p>The constitution may provide an express power of amendment, if so the procedure required in that clause must be followed. (1)</p> <p>If there is no express power, the statutory powers in the Charities Act 2011 may be able to be used. (1) Power to make an alteration by a resolution of members at a general meeting passed by two thirds of those who vote or by a decision without formal vote where no dissent is expressed at the meeting when the change is proposed (s.280). (1) Power to alter the charitable objects if the charity is small (s.275). (1)</p> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: to gain full marks, answers must state Charities Act 2011 and give the two powers (but do not have to state the section numbers).</b></p>	(4)

Question number	Answer	Mark
5	<p>The person has been involved in misconduct or mismanagement of a charity. (1)</p> <p>HMRC has decided the individual is not a 'fit and proper person'. (1)</p> <p>The person's conduct may be damaging to public trust and confidence in charities. (1)</p> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: allow full marks for three points with brief explanation or two points with more detailed explanation.</b></p>	(3)

Question number	Answer	Mark
6	B 'excluding the day the notice was sent and the day of the meeting'	(1)

Question number	Answer	Mark
7	True	(1)

Question number	Answer	Mark
8	<ul style="list-style-type: none"> <li>• A brief summary of the main activities of the charity to carry out its purposes for the public benefit. (1)</li> <li>• A statement saying whether they have complied with their duty to have regard to the guidance on public benefit issued by the Charity Commission. (1)</li> </ul> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: The answer must address the small charities requirement. Allow full marks if answer provides more detailed explanation on one of these areas (for example, summary of main activities).</b></p>	(2)

Question number	Answer	Mark
9	<p>The purpose of the Act was to provide trustees with automatic powers in relation to investments (1) and the administration of their trusts. (1) It applies to unincorporated charities and it does not apply to incorporated charities. (1)</p> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: Allow two marks for a more detailed examination of any of these points, but full marks cannot be awarded if the limitation to unincorporated charities is not included in the answer.</b></p>	(3)

Question number	Answer	Mark
10	Annual income of £5,000.	(1)

## Section B

Question number	Answer	Mark
11	<p>Less emphasis is now placed on governance structures and processes (1) and instead, when governance is reviewed, the impact of behaviour is looked at far more. (1) Governance now focuses much more on whether a board is working effectively. So, for example, in a governance review the reviewers will not just look at the structure and composition of the board but will observe its meetings to see if they are effective. (1) Organisations now give consideration to the personality of the directors, and how this impacts on the board. As an example, skills assessment will now also look at competencies and behaviours. (1) The balance of relationships, including the relationship between the CEO and the board will also be considered. (1)</p> <p>Also key to having an effective board is the matter of how well the board members work together as a group - group dynamics. Organisations will look to promote this, and better decision making through matters such as the avoidance of group think and the encouragement of constructive challenge. (1)</p> <p><b>Reward other valid responses.</b></p>	(6)

Question number	Answer	Mark
12	<p>Management accounts: assist the trustees in the financial management of the charity (1), enable monitoring of actual performance against budget, highlighting areas of discrepancy and the reasons for those (1), identify the main areas of expenditure and explain the reasons for them (1), provide understanding of the costs of the main activities (1), help identify and manage financial risks (1), assist in monitoring the correct and effective use of the charity's resources (1).</p> <p><b>Reward other valid responses.</b></p>	(6)

Question number	Answer	Mark
13	<p>Trustees' general duties are common law duties. (1) The general duties provide the principles that trustees should follow in their governance and management of the charity. (1) They are legal standards of behaviour that trustees must attain. (1) The overriding general duty is to act in what the trustees honestly believe to be the best interests of the charity (especially its charitable purposes). (1) The Charity Commission has issued guidance on these general duties which it expects trustees to read and consider. (1) The guidance points out that trustees must avoid putting themselves in a position where their duty to the charity conflicts with their personal interests or loyalties. (1)</p> <p><b>Reward other valid responses.</b></p> <p><b>Marking guidance: The question requires discussion of the duties. No more than three marks to be awarded for listing the duties without discussion.</b></p>	(6)

Question number	Answer	Mark
14	<p>(a)</p> <p>A trust separates the legal ownership of the assets from the beneficial ownership. (1) A trust has no capacity in its own right. (1) Trustees hold the assets in their own names. (1)</p> <p>(b)</p> <p>The trustees have potential personal liability. (1) The trust mechanism enables funds and other assets to be protected and administered for the benefit of the beneficiaries. (1)</p> <p><b>Reward other valid responses.</b></p>	(5)

Question number	Answer	Mark
15	<p>It is not effective for a board to take every decision in a charity, and so it will need to delegate. However, whilst a board may delegate power, it can never delegate responsibility. (1) The trustees remain liable for any actions taken on their behalf. (1) They therefore need to ensure that the powers are exercised appropriately, and that they are supervising the exercise of that power - supervision is an important part of good governance. The trustees need to monitor the exercise of the power. (1) Delegations should be documented, for clarity these should be recorded in writing. This can be in minutes, terms of reference or policies but it is good practice to have a scheme of delegation. (1) There also needs to be clarity about what has been delegated, that is, what the levels of authority are and who the authority is granted to. (1) If there is a lack of clarity, the trustees could be in breach of their duties to manage the charity's resources carefully and to act with reasonable skill and care. (1)</p> <p><b>Reward other valid responses.</b></p>	(6)

Question number	Answer	Mark
16	<p>These concepts apply to companies (1) when the company has gone into insolvent liquidation. (1) 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. (1)</p> <p>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. (1) It is much stronger than wrongful trading and requires dishonesty. (1)</p> <p>In both situations, the trustee could be held liable for the debts of the company. (1)</p> <p><b>Reward other valid responses.</b></p>	(6)

# Section C

Question number	Indicative content
17	<p><b>Statutory registers</b> – Companies limited by guarantee (companies) and CIOs must both keep statutory registers.</p> <p>However there are differences in the detail of what registers must be kept, what information is required in those registers and in the rights of access to the registers.</p> <p>Companies must keep registers of members, of directors, of directors’ residential addresses, of charges, and of persons of significant control. If a company has a secretary it must also keep a register of secretaries.</p> <p>CIOs must only keep registers of members and of trustees.</p> <p><b>Access rights – registers</b></p> <p>For CIOs, the public have the right to inspect or ask for a copy of the register of trustees. However only members and trustees, not the public, can inspect or ask for a copy of the register of members and (subject to conditions, for example, the request must be made for certain purposes specified in the regulations).</p> <p>For companies, the public can access all registers except the register of directors’ residential addresses. However the Companies Act specifies that access to the register of members may only be for ‘proper purposes’ and a company may refuse an access request that is not made for a proper purpose.</p> <p>Members can access the register of members and the register of directors and of charges (and any register of secretaries).</p> <p><b>Other records</b></p> <p><b>Employment records</b> – A charity of either type that has employees must keep relevant required records, for example, employee records and PAYE, pensions and National Insurance records.</p> <p><b>Meetings and decisions</b> – A charity of either type must keep minutes of meetings but there are differences in the detail of the requirements:</p> <p>A company must keep minutes of general meetings of members (for at least 10 years), whereas a CIO also has to keep records of proceedings at general meetings of the CIO’s members.</p> <p>A company must keep minutes of all board meetings and all meetings of committees of the board, again for at least 10 years.</p> <p>A CIO must keep records of meetings of its trustees and committees of its board of trustees.</p> <p>A CIO must also keep records of decisions made by its trustees other than at board meetings.</p> <p>The minimum time for these CIO records to be kept is six years.</p> <p>The obligations for companies are set out in the Companies Act 2006, for CIOs they are set out in the CIO regulations.</p> <p><b>Inspection/access rights – minutes and meetings/decisions records</b></p> <p>The Companies Act 2006 gives access rights to the auditors for minutes of all meetings.</p> <p>Members of the company can inspect minutes of general meetings but cannot access board meeting minutes unless the company’s articles give them that right. Directors (the trustees of a charitable company) can access board and board committee meeting minutes and also minutes of general meetings of the company’s members.</p> <p>The public have no automatic legal rights to inspect any of the above.</p>

	<p>In CIOs, members can access the records of members' decisions.</p> <p><b>Reward other valid responses.</b></p>	
Level	Mark	Descriptor
	0	No rewardable material.
<b>Level 1</b>	1–5	<p>A few key points relating to the legal requirements for keeping records for CIOs and companies are given/compared, <b>or</b> one point is compared and contrasted in some detail. The answer is likely to be in the form of a list, with very little reference to the legislation supporting the requirements, or the processes that are followed, or good practice. Points made are superficial / generic and not applied or directly linked to the requirements of the question.</p> <p><b>Award up to a maximum of only 5 marks if the answer comprises a list of recalled knowledge on the topic and does not attempt to address the requirements of the question.</b></p>
<b>Level 2</b>	6–10	<p>Some points regarding the legal requirements for keeping records for CIOs and companies are compared and contrasted, <b>or</b> a few points are compared and contrasted in some detail. The answer is unbalanced, with more emphasis on some registers/records than others, or with more emphasis on CIOs over companies, or vice versa. Most points made are relevant to the question but the link is not always clear. The answer shows some understanding but may not show a fuller knowledge of all the requirements.</p>
<b>Level 3</b>	11–15	<p>A range of points regarding the legal requirements for keeping records for CIOs and companies are compared and contrasted, <b>or</b> a few points are compared and contrasted in some depth. The answer is well-balanced, with equal weight given to the different registers/records and to both CIOs and companies. The majority of points made are relevant and there is a clear link to the requirement of the question. The answer demonstrates accurate knowledge of the legal source of particular requirements, such as the relevant statutory provision, and includes commentary on related legal rules, such as access/inspection rights.</p>

Question number	Indicative content
18	<p><b>Primary purpose trading</b></p> <p>A charity can trade in direct pursuit of its charitable purposes, for the public benefit. This is distinguished from commercial trading, or trading to general funds. This is non-primary purpose trading, and must be treated with caution. If undertaken on a large scale, or to the detriment of the charities funds, in may incur a tax charge, or potentially prejudice the charity's charitable status. It is for this reason that charities often establish a trading subsidiary. The charity in this question gains its income in three ways:</p> <ul style="list-style-type: none"> <li>• the café;</li> <li>• the sale of merchandise in the shop; and</li> <li>• grants and contracts for the provision of its services.</li> </ul> <p>The last of these is clearly primary purpose trading, and is already treated as such. However, the other two sources of income are dealt with via the trading subsidiary. This may not be necessary. The café appears to be used as a way of employing the beneficiaries of the charity, and it is very likely that the income from the café is therefore primary purpose income. It could therefore be managed directly by the charity, with no need for a trading subsidiary. The sale of merchandise in the shop looks much more like trading to generate funds. However, a certain level of fundraising trading can usually be carried out directly by a charity (tax free). This is the 'small-scale exemption' (section 46 of the Finance Act 2000). This exemption applies provided the turnover is less than 25% of the charity's total incoming resources in a year (from all sources), subject to a maximum level of £50,000 turnover in a year.</p> <p>At the current time, the level of income from the merchandising, including the money that the board has just voted to spend on new merchandising, seems to be within these thresholds. So the charity could potentially deal with these sales directly, with no tax implications. However, if the turnover increased, it could still be beneficial to manage it via a trading subsidiary.</p> <p>The charity has a trading subsidiary to carry out the trading activities, and then transfer its profits (or a proportion of them) back to the charity. Companies can make donations to charities under the Gift Aid scheme, provided the gift meets relevant conditions. The gift is made from pre-tax profits so it avoids corporation tax on those profits. Where a charity has a trading subsidiary it often uses all its trading through that subsidiary, even primary purpose trading for ease of administration. So having a trading subsidiary helps to avoid tax and to ensure that the charity is operating within charity law. However, the charity will need to ensure that it is maintaining separation between both organisations, for example, different bank accounts, agreements for use of staff time, office space and so on. The trustees must ensure the charity pursues its charitable purposes and that its activities and the use of its funds and assets are directed only to that end. The fact that the board membership is identical to the trading subsidiary board membership, and the fact that it is the charity board and not the trading subsidiary board that has voted to purchase the new merchandise, indicates that in this example, there is not a clear distinction between the charity parent and the subsidiary. If the subsidiary is maintained, these matters need to be addressed.</p> <p>As the same people are on the boards for both the charity and the subsidiary, there is also an issue in regard to conflicts of interest. For the subsidiary, a company director must avoid any situation in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of their company (Companies Act 2006, s. 175). This can be disapplied by the board if there is a specific empowering provision of the individual company's articles. It is also arguable in a wholly owned subsidiary, that acting in the interests of the sole</p>

shareholder is promoting the success of the company. So the issue of conflicts of interest for the subsidiary board membership can be dealt with. However there is still a conflict of interest for the trustees, when sitting on the charity's board.

Trustees have an overriding duty to act in what they honestly believe to be the best interests of the charity and, therefore, must be diligent in avoiding potentially harmful conflicts of interest. This duty cannot be disapplied, as it can in a non-charitable company and, therefore, the charity must have some trustees who are not also subsidiary board members to deal with any decision where a conflict arises.

So, the charity board could decide to no longer use a trading subsidiary. If it did so, it would need to take care regarding the fundraising income to ensure that it did not rise above the threshold, or if so that tax was paid, and that it met its legal duties in regard to this type of income. It would need to follow the Charity Commission guidance on trading, and ensure that the charitable funds and assets were always directed to the pursuit of the charities objects. Also, they would need to consider matters such as the risk management, including risk of loss, misapplication of charitable funds and potential reputational damage. Finally, it would be important to check and observe any trading restrictions in the charity's constitution.

**Reward other valid responses.**

Level	Mark	Descriptor
	0	No rewardable material.
<b>Level 1</b>	1–5	A few points regarding trading and the way the law regarding trading applies in this question are identified <b>or</b> one key point is discussed in some detail. The answer is likely to be in the form of a list, with little or no advice on the legal or governance issues in the scenario, or how the charity board might change its approach. The answer may focus only on the legal and governance issues the charity faces, without how it might change its approach, and without presenting this as advice to the charity. The points made are superficial / generic and not applied to the requirements of the question. <b>Award up to a maximum of only 5 marks if the answer comprises a list of recalled knowledge on the topic and does not attempt to address the requirements of the question.</b>
<b>Level 2</b>	6–10	Some points regarding trading and the way the law regarding trading applies in this question are discussed <b>or</b> a few key points are discussed in some detail. The answer is unbalanced, with more focus on some of the legal and governance issues in the scenario than others. Most points made are relevant to the requirements of the question but the link is not always clear – some legal and governance issues may be missing or the answer may not always link to the case of the charity in the question. The answers may contain some gaps in knowledge or inaccuracies but still demonstrates an overall level of understanding. It may also address the matters of trading well, but not address the issue of the conflict of interest.
<b>Level 3</b>	11–15	A range of points regarding trading and the way the law regarding trading applies in this question are discussed <b>or</b> a few key points are discussed in depth. The answer is well-balanced, with equal weight given to each issue. The majority of points made are relevant to the requirements of the question, to advise the charity board on the legal and governance issues, and with a range of suggestions for how the charity can deal with its trading in the future. Answers show a good understanding of the conflicts of interest issues raised and explain how this relates to the scenario.

Question number	Indicative content
19	<p>Answers to this question should be worded as a response to the Chair. They can be set out as an email, letter or report, but the tone of the answer must be appropriate. It should show that the candidate has an awareness of how best to communicate news that the Chair will be unwilling to hear.</p> <p><b>Legal / constitutional issues</b></p> <p>The first point to deal with is a possible written resolution of the members and if this decision can be treated as one. If it is assumed that the Articles do not make provision for written resolutions, then the charity has to rely upon the provisions of Companies Act 2006. Sections 288 – 300 allow written resolutions to be passed by 75% of members (all members, not just those voting). However, whilst it may seem as if this matter has 75% support, there are a number of issues:</p> <ul style="list-style-type: none"> <li>• Notice of the resolution was not sent to all members – Susie and Jock would have also needed to receive notice.</li> <li>• What the members have been asked about (handing the matter over to the Chair) is not worded as a resolution to remove a board member. Just as notice of a meeting must set out the wording of a resolution, so should a request for a written resolution.</li> <li>• Section 168 of the Companies Act 2006 gives members the power to remove board members, but if there is no provision on the Articles to cover this removal and this power is relied upon, the Companies Act 2006 prevents a written resolution from being used.</li> </ul> <p>The Chair has also suggested that the written resolution could be regarded as a written resolution of the board. The Companies Act 2006 makes no provision for board written resolutions and so there would need to be provision in the Articles to allow for this. If there was a clause allowing directors to take decision by written resolution, there would still be the fact that not all trustees had been notified. It is possible that the charity could argue that Susie was excluded due to her conflict of interest, but this would not apply for Jock. Finally, there would need to be express provision in the Articles allowing the board to remove a board member and not placing limitations upon this.</p> <p>Common law allows decisions to be taken unanimously, without the need for a formal meeting. This can apply for both member decisions, and board decisions. However as there must be complete unanimity, both Susie and Jock would also need to be notified, and to vote in favour.</p> <p>The Chair should therefore be advised that this removal has not taken effect. If he still wants Susie to be removed, he would need to check the Articles to see:</p> <ul style="list-style-type: none"> <li>• Could the Board remove a trustee?</li> <li>• Could members remove a trustee by written resolution?</li> </ul> <p>If not, the board would need to convene a general meeting to remove Susie under s.168 of the Companies Act 2006. Full notice will need to be given as it is unlikely that they could achieve the 90% requirement for the members' agreement to short notice (as Susie would be unlikely to agree).</p> <p><b>Governance issues</b></p> <p>The email suggests a number of governance issues that will impact on the effectiveness of this board. It would be advisable to review these before removing Susie:</p>

- There is a need for independent thought and constructive challenge on boards and this appears not to be recognised.
- There appears to be an issue in the quality and detail of the information being provided to the board. This potentially impacts on the boards' ability to make decisions and to monitor fully.
- The Chair appears to be very dominating. This will impact the effectiveness of the meetings, and how well the board works together as a collective decision making group. It raises the question of whether all trustees are fulfilling their role.
- How the board works together is fundamental and a key component of good governance. The approach of the Chair, whilst it seems to be about creating a unified board, is actually working against building an effective team.

There is also a question in regard to conflicts of interest, and whether the Chair would be seen to be acting in the interests of the charity, and not having regard to his own personal interests.

Alternative approaches include:

- Undertaking work on group dynamics, and building a more effective board.
- Reviewing the information provided.
- Training and development options for the Chair.
- Better understanding of the role of trustees.
- Ways the charity could review the effectiveness of its governance.

**Reward other valid responses.**

Level	Mark	Descriptor
	0	No rewardable material.
<b>Level 1</b>	1–5	A few key points on the governance and legal issues in the scenario are described <b>or</b> one factor is described in some detail. The answer is likely to be in the form of a list and not as a response to the Chair. There is very little reference to either the legal / constitutional issues or the governance issues in the scenario, <b>and/or</b> no alternative approaches are suggested. The points made are superficial / generic and not applied to the requirements of the question.  <b>Award up to a maximum of only 5 marks if the answer comprises a list of recalled knowledge on the topic and does not attempt to address the requirements of the question.</b>
<b>Level 2</b>	6–10	Some points regarding the governance and legal issues in the scenario are discussed <b>or</b> a few key points are discussed with some links made to the scenario. The answer may not explore the full range of matters, or may contain some inaccuracies in regard to the legal and constitutional matters. The answer may contain relevant analysis, but is not worded appropriately as advice to the chair in this scenario. The answer may suggest an alternative approach, but this could be limited to either legal and constitutional issues, or governance.
<b>Level 3</b>	11–15	A range of points regarding the governance and legal issues in the scenario are discussed <b>or</b> a few points are discussed in some depth. The answer is well-balanced and a majority of points made are relevant and there is a clear link to the requirement of the question. There are detailed observations on the scenario and there is in-depth understanding of the governance matters. The answer is worded appropriately and suggests alternative approaches for both removing the board

		member, and retaining her and addressing the governance matters the charity would face in trying to manage these risks.
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