



## ACCOUNTING SERVICES FOR THE VOLUNTARY SECTOR

### FACTSHEET NUMBER 7 - CONFLICTS OF INTEREST

#### 1. Introduction

The question of conflicts of interest in the context of Charity trustees is a legal minefield, having a much wider-reaching scope that is often appreciated. All boards of trustees / directors should take the time to ensure that at least one of their number has a grasp of the legal requirements and that steps are taken to ensure full compliance. Failure to do so could result in transactions being invalidated and trustees becoming personally liable.

This factsheet offers only an introduction, indicating the scope of the regulations involved. For each topic, a key text is identified which offers a fuller exposition.

#### 2. Conflicts – Charity Law

Key text – <i>A Guide to Conflicts of Interest</i> – Charity Commission
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##### 2.1 Conflicts exist where any trustee or a connected person:

- has a financial interest in a contract
- uses the organisation's services and stands to lose if they are withdrawn
- has a personal obligation to a beneficiary of the organisations services
- obtains valuable information which could provide a personal benefit
- has obligation from another role which conflict with the interests of the organisation

##### 2.2 The Charity Commission identifies three levels of response to a conflict

- Minor conflicts – the trustee does not participate in discussion
- Larger conflicts – the trustee leaves the meeting
- Major conflicts – the trustee resigns

Overall, the principle is that there must be a 'disinterested quorum' to make a decision. If this is not possible, the permission of the Charity Commission should be sought to amend the governing document to deal with the situation.

**2.3** Connected persons are not fully defined in this context but may be considered to be widely drawn. One possible guide would be the definition of connected parties for the purposes of trustee remuneration (see 3.6 below).

**2.4** Special rules apply where land is sold to a connected person.

### 3. Payments to trustees

Key text - *Trustee expenses and payments* – Charity Commission

**3.1** A particular type of conflict of interest is payments to trustees, particularly for services. It has always been the case that trustees are entitled to have their expenses met from the funds of the charity

**3.2** Charities can now pay some of their trustees for the supply of services. The power to do this, and the conditions attached to using it, were introduced by the Charities Act 2006 as a change to the Charities Act 1993. The power cannot be used if the governing document prohibits this type of payment.

**3.3** A charity trustee may only be paid for serving as a trustee where this is clearly in the interests of the charity and provides a significant and clear advantage over all other options. There is no general power in law for this type of payment - a charity would need a specific authority which may be found in its governing document, or be provided by the Commission, or, more rarely, the Courts.

**3.4** Where a charity proposes to employ a trustee in some other role, or where a charity wishes to compensate a trustee for loss of earnings to enable them to attend meetings during working hours, it must firstly ensure that it has the necessary authority. If it is not provided by the governing document, the charity will need to approach the Commission or the Courts.

**3.5** If a trustee board is considering whether to make a payment to a trustee (as opposed to reimbursement of expenses) there are six key factors to consider:

- Who will receive the payment - will it be a trustee, or a person or business connected with a trustee?
- What is the payment expected to cover?
- Is the payment clearly in the best interests of the charity?
- Is there a legal authority for it?
- What conditions must be met if the payment is to be made?
- How will any conflict of interest be managed?

**3.6** Payments to connected persons apply equally as payment to trustees. In this instance, a definition is provided which includes (i) spouse or partner, (ii) children, parents, grandparents etc, (iii) business partner and institutions or companies controlled by the trustees and connected persons as above.

### 4. Conflicts - Companies

Key text – *Companies Act 2006 – ss175-177*

**4.1** Many charities are companies limited by guarantee and, where this is the case, a further raft of regulations needs to be considered. Here the approach is to recognise three types of conflict.

- **Transactional conflicts** – a director who has a financial interest in a transaction, director indirect must make a declaration of interest. In non-charitable companies, some major transactions need to be authorised by the members. In charitable

companies, such transactions may need to be authorised by the Charity Commission.

- **Third party benefits** – these should not be accepted unless trivial.
- **Situational conflicts** - these arise where there is ongoing potential for conflict even if such conflict never arises and a director has a general duty to avoid them. To prevent difficulties it is necessary to identify all such matters and deal with them either in accordance with the memorandum and articles (if permitted), or by reference to the Charity Commission.

**4.2** These rules apply equally to connected persons of a trustee. For company law, the definition is different, not including grandparent or grandchildren, but having a wider definition of connected companies, the threshold been 20% ownership, and companies where the trustee is a director.

## 5. Disclosure

Key text - *Accounting and Reporting by Charities: Statement of Recommended Practice* – Para 221-230, GL 50.

**5.1** Generally, there is a wide requirement to disclose any transaction in the annual accounts where there is a potential conflict of interest. These are known as '*Related Party Transactions*'. Related parties include not just trustees but also corporate bodies who exercise some control over it.

**5.2** Transactions requiring disclosure include sales, purchases, donations, grants, trustee expenses and trustee remuneration.

**5.3** Again, transactions with connected parties are of equal relevance. They include family members, business partners, lined trustees and linked companies (based on controlling interest test).

## 6. Action points

**6.1** Charities should have clearly defined procedures for identifying and managing conflicts of interest. Ideally, these procedures should be set out in the charity's governing document.

**6.2** Ensure all trustees are briefed about their duties and responsibilities

**6.3** In many cases the Articles of Association of charitable companies will need amending to take account of situational conflicts.

**6.4** There should be a register of conflicts of interest available for inspection by all trustees

## Disclaimer

This factsheet is for general information only and is not intended to be advice to any specific charity. Professional advice should be taken in respect of individual circumstances. The checklist represents my understanding of charity and taxation law and practice as at December 2010, which is subject to change.