

7: Community Interest Companies: Directors' Legal Responsibilities

1. Context

Community Interest Companies, although they have their own regulator, are in all other respects companies governed by the Companies Acts. The Board of Directors is the company's highest authority. However, the company directors do not wield unlimited power.

Their legal duties, and the limits of their powers, are set out:

- in the **Companies Act 2006 (CA)**, and
- in the company's governing document or constitution: the **Articles** (new format) or **Memorandum and Articles** (old format)

Also, directors' decision-making is subject to the laws of the land (e.g. employment, discrimination, safeguarding, data protection, health and safety, money laundering, immigration, taxation).

2. Duty 1: Observe the constitution

The first legal duty of directors under the Companies Act is to "act in accordance with **the company's constitution**, and only exercise powers for the **purposes** for which they are conferred" (CA 171). (For Companies Act in full, see www.legislation.gov.uk).

The constitution may take the old form (content separated into Memorandum and Articles) or the new form (content solely in the Articles, with the Memorandum just for the original signatories). The order is slightly different but they are otherwise the same.

3. The Articles

The Articles will cover (not always in this order):

- the **asset lock** (equivalent to a dissolution clause in a charity), setting out the permissible use of any net assets if company has to close down and (optionally) naming the potential beneficiary organisation
- (optionally) the company's **legal purpose** (the objects), which will be specific to each company
- the **powers**, which are generic and mostly standard practice (employ staff, rent premises etc.)
- the rules (if any) on **public and private benefit**
- **limited liability**, which limits members' legal liability for any commercial debts (typically to £1 or £10 per member), assuming the company is limited by guarantee (companies limited by shares will have share-holding rules instead);
- **Directors'** powers, responsibilities and decision-making, including quorum, rules on **conflicts of interest**, appointment and retirement
- the **Membership** rules (if any)
- the **General Meeting** rules, covering notice, resolutions, quorum, voting (NB Companies Act requires provision for proxy voting)
- powers or policy (tailored) on **directors' indemnity** cover

- some standard clauses covering communication, keeping of accounts and serving notice

4. Duty 2: Acting in good faith

The second legal duty of directors under the Companies Act (CA 172) is to act “in good faith” ... “to promote the success of the company for the benefit of its members as a whole”. When taking decisions, directors should consider:

- a) the likely consequences of any decision in the long term
- b) the interests of the company's employees
- c) the need to foster the company's business relationships with suppliers, customers and others
- d) the impact of the company's operations on the community and the environment
- e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- f) the need to act fairly as between members of the company

5. Duty 3: Independent judgement

The third legal duty of directors under the Companies Act (CA 173) is “to exercise independent judgment”.

6. Duty 4: Care, skill and diligence

The fourth legal duty of directors under the Companies Act (CA 174) is to “exercise reasonable care, skill and diligence.” This means the care, skill and diligence that would be exercised by a reasonably diligent person with:

- a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
- b) the general knowledge, skill and experience that the director has

7. Duties 5-7: Conflicts of interest and personal benefit

The fifth legal duty of directors under the Companies Act (CA 175) is to “avoid conflicts of interest” or “conflicts of duty”, whether actual or potential. “This applies in particular to the exploitation of any property, information or opportunity.”

The other directors (acting without the conflicted director) may authorise the conflict, provided “nothing in the company's constitution invalidates such authorisation”. If there is a public benefit clause, it may well invalidate any such authorisation.

The sixth legal duty of directors under the Companies Act (CA 176) is *not to accept* any benefit from a third party arising from either (a) being a director, or (b) doing or not doing anything as a director, unless this cannot reasonably be regarded as likely to give rise to a conflict of interest or duty.

The seventh legal duty of directors under the Companies Act (CA 177) is to declare to the other directors the nature and extent of any interest, direct or indirect, in any proposed transaction or arrangement with the company.

If you will have four or fewer directors when you set up, you will need to detail any Persons of Significant Control. This applies whether you are setting up a CIC limited by shares or guarantee. Anyone with more than 25% control in a company is defined as a Person with Significant Control (PSC).

8. Evidencing compliance

Keep accurate Board minutes, complete with any briefing documents considered as part of the decision-making. Retain them for at least 10 years (legal minimum).

9. Company administration duties

The main duties, for which all directors hold a legal responsibility, are:

- to submit annual accounts within 9 months of year-end (for the company by 31 December each year)
- to submit a confirmation statement (formerly annual return) on time (for the company by 20 June each year)
- to notify all changes of directors' details within 14 days
- to notify any changes to the governing document within 15 days

See Companies House website for:

- [full details of requirements](#)
- [the company filing history](#)

10. Legal risk type 1: Breach of contract

E.g. failure to pay bills, carry out repairs.

General liability: the company.

Director personal liability:

- contracts outside objects and powers
- acts beyond personal authority
- operating when insolvent

Risk management:

- governing document
- financial procedures
- financial monitoring

11. Legal risk type 2: Statutory breach

E.g. food hygiene, unfair dismissal.

General liability: the company.

Director personal liability:

- PAYE
- health and safety
- breach of Companies House rules
- operating when insolvent

Risk management:

- clear procedures, monitoring and review
- effective Company Secretary, Treasurer roles

12. Legal risk type 3: Criminal offences

Example: drugs on the premises, money laundering, terrorism, child abuse.

Liability: Either the company or individual Directors could be prosecuted.

Risk management:

- well-informed Directors, staff, advisors
- monitoring of staff, money, safeguarding
- regular financial reports

13. Legal risk type 4: Civil wrongs (Tort)

Examples: negligence, nuisance, defamation.

Liability: either the company or individual Directors could be sued.

Risk management:

- HR procedures (training, supervision, delegation)
- speak “on behalf of the organisation”
- keep timely records of incidents
- effective complaints procedure

14. Risk and insurance

Insurance is essential for:

- Employer’s Liability (if staffed; display certificate)
- Public Liability (for premises or public activities)
- Professional Indemnity (for advice work)

Either one or two should cover volunteers.

Check that staff car insurance covers company business.

Buildings cover may be a lease requirement.

15. Directors as employers

The Board has two key roles. It needs to:

- develop, maintain and follow a full range of personnel policies (either develop and maintain a high level of in-house expertise or subscribe to an hr support service)
- ensure staff members receive effective support and line-management



16. Managing volunteers

Much of HR policy (health and safety, conduct etc.) will also apply to **volunteers**, but a clear distinction between staff and volunteers is vital.

Staff need employment contracts.

Volunteers need non-contractual agreements. They should only be reimbursed for actual expenses, supported by receipts.

A Volunteering Policy would be useful.

17. Health and safety

Directors are responsible for all staff and volunteers.

Funders may have specific requirements.

Policy should cover training, risk assessment, monitoring.

Risk assessment should cover:

- hazard identification
- potential risks (how? how serious? who is at risk?)
- preventative measures
- emergency procedures

18. Financial planning

Directors must ensure that there is:

- an Income and Expenditure budget
- a Cash-flow budget (if income is uneven or deferred, or if solvency is uncertain)
- regular monitoring and review
- assessment of any VAT liability

Plans should be risk-assessed.

19. Financial records

Directors must ensure that:

- clear financial records are kept, e.g. cash book, bank statements, petty cash, bank reconciliations, assets, PAYE payments, bills
- records are retained for six years

20. Financial procedures

Directors must ensure formal written financial procedures to produce a clear “audit trail” and safeguard the charity from misappropriation or loss:

- delegation of financial authority (authorisations, cheque and card use)
- record keeping
- petty cash
- PAYE
- secure storage
- personal safety



21. Financial reporting

Directors must ensure key requirements are met:

- production of annual accounts
- submission to Companies House

For a small company (under £10m turnover, under 50 staff), a formal audit is not required. However, annual independent examination is required and is likely to be specified under the company articles. Funders may also have specific requirements.

22. Project grants and contracts

Directors need to know and understand:

- What are we expected or required to deliver?
- Specific requirements: quality marks, insurance, referral sources, monitoring, reporting?
- Duration? Renewable? Requirements for renewal?

Grant or contract? If a contract, you could be liable for more than repayment in the event of failure.

Does the income count towards the VAT threshold (£85k pa in 2019)? Check with your accountant.

23. Directors and premises

Directors need to understand the legalities:

- Powers in the governing document?
- Lease or licence?
- Duration? Break clause?
- Cost? Rent reviews (how often)?
- Repairs (structural/decorative), insurance?
- Power to sub-let?

Take **legal advice** before signing a lease.

24. Directors and data protection

A brief summary of a complex subject

The European General Data Protection Regulation 2018 (GDPR), tailored by the UK Data Protection Act 2018, covers:

- *personal* information (about living people)
- information held manually and electronically

There are seven data protection principles under GDPR:

- 1) Lawfulness, fairness and transparency
- 2) Purpose limitation
- 3) Data minimisation

- 4) Accuracy
- 5) Storage limitation
- 6) Security
- 7) Accountability (need to evidence compliance)

Lawful grounds for processing (for the company) are likely to be either:

- Consent (freely given and retractable), or
- Legitimate interest (necessary in order to provide a service)

Data subjects now have extensive rights:

- to access their personal information at no cost
- to receive privacy information
- to demand rectification or erasure
- to object to or restrict the use of their data
- to get their data back, in appropriate form (portability)

Directors need to assure themselves that these basic rules are being observed.

25. Safeguarding and disclosure

Directors have to balance:

- a duty of confidentiality to service users (Data Protection)
- a possible duty to disclose to safeguard those at risk (Children, Vulnerable Adults)

A Confidentiality Policy is needed.

26. Further information

- The Russell-Cooke [Voluntary Sector Legal Handbook](#)
- Subscribe to [Sandy Adirondack's update service](#)
- [Office of the Regulator of Community Interest Companies](#)
- Contact us for further support on 0333 321 3021 or info@mcrcommunitycentral.org

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