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AIM Guides for Boards

# Keeping up to date – reviewing your organisation's governing document & legal form

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## Introduction

This guidance note is intended to help trustees of museum and heritage organisations ensure that the legal form of their organisation remains fit for purpose. It covers both the need for regular review of the governing document and circumstances in which trustees might wish to change the legal form.

## The Governing Document

A governing document specifies an organisation’s purposes, and how it is to be administered. The type of document depends on its legal structure. Those most commonly found in independent museums are the Constitution, Trust Deed, Charity Commission Scheme, and Memorandum & Articles of Association. Sometimes the governing document may not be a single text, but a series of separate papers. For example, Deeds of Trust may have been modified by supplementary Deeds or Charity Commission Schemes; or Orders that authorise actions that fall outside of the rules in the governing document. In Scotland substantial changes to governing documents may require a Court Order.

Governing documents, of whatever type, are binding in law on all those included within their provisions, so it is important that each of those persons has easy access to an up-to-date copy. All the people who share ultimate responsibility for the control and direction of the organisation (‘trustees’ where the museum is a charity) should have their own personal copy. It should be a regular point of reference so as to ensure that the rules and regulations it prescribes are followed on every occasion. As governing documents vary between organisations – even between bodies of a similar nature – familiarity with the provisions of the governing document of one entity cannot be assumed to apply to another.

Compliance with governing documents is a statutory requirement for both charity trustees and company directors. Failure to do so can, at best, lead to tensions amongst trustees. In extreme cases, by depriving trustees of the proof necessary to rebut challenges, it has the potential to cause the validity of decisions made by trustees to be called into doubt. At worst, it might expose trustees to allegations of acting in bad faith and being in breach of trust, which would carry the risk of financial liability.

## Changing the Governing Document

As the years pass, the governing document that created a museum may no longer be appropriate to its current circumstances. Sometimes the changes need to bring it up-to-date are small, and most governing documents describe a procedure that enables such revision. Copies of the resolutions making such changes, and a copy of the revised governing document, must be filed with the relevant regulators. Where the governing document makes no provision for amendment, then there are statutory or regulatory procedures that will need to be followed to enable such changes to be made.

Sometimes, however, more substantial reform may be required. Typical reasons for such major change are:

### **Growth**

Many museums start with a small number of people operating under a Deed of Trust or similar document, or with a larger group of individuals setting out rules that define their aims and administration, which usually includes the appointment of a managing committee. In both situations any property or contracts are held by individuals on behalf of the museum. It would be these individuals that would be parties to any legal actions in their own names, and so carry personal liability. Such bodies are described as ‘unincorporated’.

If the museum remains small, such an arrangement may be entirely satisfactory. However, if it develops to the extent that it needs to employ staff, own or lease premises, or enter into contracts with suppliers or funding bodies, then it becomes desirable for it to acquire a ‘legal personality’ of its own. By so doing it can be party to legal processes and proceedings in its own name and limit the liability of its trustees and members. Such a change involves a process termed ‘incorporation’.

### **Legislative Change**

New legislation can result in some provisions of governing documents becoming obsolescent, or create opportunities for existing rules to be updated so that they better reflect contemporary circumstances. Since 2005 there has been substantial changes to company and charity law throughout the UK, and it is likely that the governing document of any charity or company predating such legislation would benefit from updating.

### **Consolidating Previous Amendments**

An organisation that has made regular amendments to its governing document over the years may find that a consequence has been inconsistencies in the text or that there is confusion as to what is the current version. A time comes when it is desirable to revisit and revise to ensure that the governing document is a congruent whole. Similarly, where the governing document is a series of inter-related texts of different dates, their consolidation into a single document can be helpful.

### **Changes in Purpose**

There is limited scope for changing a charity’s primary purposes, and its assets can only be used for the purposes for which it was established. Although activity can be focused within those ‘charitable objects’, going beyond their boundaries is unlawful. Where an organisation wishes to develop so that its activities fall outside of the scope of its original objects it will be necessary to create a new entity with the desired broader purposes. While the existing charity’s assets may be transferred to that new charity, they have to be ring-fenced so that they are applied only to the original charitable purpose, not the broader remit of the new entity. The funds for its new activities will have to come from other sources.

### **Changes in Nominating Rights**

Many governing documents enable other parties (such as local authorities, learned societies, universities, founders etc) to nominate persons to the museum’s governing body. Sometimes such rights fail to be exercised for an extended period of time; or a nominating body may disappear as a result of amalgamation or abolition. For organisations with a substantial number of nominating bodies, such changes can have an impact on the way the board works. A review in response to such change might question whether such nomination rights continue to be appropriate, especially where the nominated member might have a conflict of interest/loyalty between the body that appointed them and the museum.

It should be clear to all that both charity trustees and company directors have analogous statutory duties only to act in the best interests of that charity/company, irrespective of the interests of any organisation that may have appointed them to that office. A Conflicts of Interest Policy, and maintenance of a register of directors’/ trustees’ interests helps to achieve this.

Relationships with funding bodies are better conducted by formal written agreements between the parties than by the right to attend meetings, whether as a trustee or as an observer.

### **Care & Maintenance**

Other factors that might suggest that a full review would be timely might be where:

- the governing document has remained unchanged for an extended period of time (say longer than fifteen years);
- there have been five amendments to the governing document during the preceding ten years period; and
- there is divergence from the practice specified in the governing document on a continuing or regular basis, even when the trustees unanimously agree to such variances and it has become ‘custom and practice’.

## How to Change a Governing Document

### **Unincorporated Bodies**

Unincorporated associations and charitable trusts are free to make such changes as they wish to their constitution, provided that the procedures specified in the existing constitution are met, and the majority of members required by the governing document agree to that change.

### **Incorporated Bodies**

The Companies Act 2006 requires that any change, however trivial, to a Memorandum & Articles created under earlier legislation will trigger the updating of the whole of the governing document so that it meets the requirements of the 2006 Act.

In particular, the form of the Memorandum & Articles has been superseded. Previously the Memorandum set out the company’s purposes (‘objects’) and what it could do to carry out these purposes (its ‘powers’). The Articles specified how it is to be administered. Nowadays the Memorandum has become nothing more than a statement of intent to register a company, and so is of no further practical use following incorporation; it is the Articles that now include the company’s purposes and powers that were formerly in the Memorandum, as well as its administrative regulations.

The scale of the change required suggests that a thorough review will need to be undertaken, both to see whether the charitable company remains the best option for the museum, rather than becoming a charitable incorporated organisation (see below). If it is decided to remain as a company, then consideration should be given to amending the Articles, whether by adopting the innovations in the 2006 Act or including the changed statutory requirements.

The legislation made provision for:

- rules for the conduct of general meetings:
  - a. annual general meetings are no longer a statutory requirement (although it is good practice for the Articles to make provision for such meetings), which may be especially useful where the trustees and the members are the same people;
  - b. the category of ‘extraordinary’ general meetings has been discontinued and company meetings are now simply ‘general’ meetings;
  - c. notice periods for general meetings are reduced to 14 days and 90% of the voting members can agree to a meeting at shorter notice
  - d. members have the right to appoint proxies and notices of general meetings must refer to this right
  - e. the chair cannot have a casting vote at a general meeting;
- written resolutions of members no longer require unanimity, but can be passed by a 50% for ordinary resolutions and 75% majority for special resolutions,
- formal correspondence between a company and its members can be conducted by electronic communications, subject to conditions;
- there is no longer a requirement to have a company secretary (but the trustees must make arrangements for the discharge of those functions that formerly fell within the remit of this role); and
- the minimum age of trustees is 16 years.

## Incorporation of Unincorporated Bodies

This is the process to change an unincorporated body (one created by a Trust Deed or equivalent, or an association of members) into an entity that has its own legal personality. It requires the creation of a new organisation with a form of governing document prescribed by statute as being appropriate, which is registered with the appropriate regulators. Although this is sometimes described as ‘conversion’, this is not strictly so, and is rather a transfer from an existing operation to a newly-created one.

The forms of incorporation used by museums are as follows:

- the charitable company limited by guarantee – this the traditional form used to incorporate independent museums, and is available throughout the UK; and

- the charitable incorporated organisation (CIO) – this form has been available in Scotland (‘SCIO’) since 2011 and in England and Wales since 2012; legislation to introduce CIOs in Northern Ireland has been enacted but not yet implemented.

The change process involves separate applications to the appropriate charities regulator; if a charitable company limited by guarantee is intended, then the company must be registered with Companies House before application for charity status is made. Nowadays all applications can be made online.

The following tables summarise the advantages and disadvantages of the two forms.

### Charitable Company Limited by Guarantee

#### Advantages

- Speedy process of incorporation (though registration as charity may take several months)
- tried and tested arrangement familiar to funders, banks, suppliers
- greater flexibility in design of governing document
- can offer debenture or secured charge over assets
- majority decisions on written resolutions available
- trustees have always to act in the best interests of the charity
- can continue in being if ceases to be a charity (but charity assets have to be transferred to another charity with similar purposes)

#### Disadvantages

- compliance is required with both company and charities law, which may not be the same
- filing regime and onerous penalty charges for non-compliance
- (modest) fees charged on incorporation and filing annual return
- statutory requirement to maintain extensive suite of company records
- members have right to act in own best interests rather than that of the charity

### Charitable Incorporated Organisation (CIO)

#### Advantages

- designed specifically for charities
- avoids double registration with both charity regulators and Companies House
- duty of acting in the best interests of the charity falls on both trustees and members
- subject to charity accounting regulations, so accrual accounts not required if turnover less than £250k
- less rigid regime for electronic communications
- Regulations not punitive
- choice between ‘association’ model (for membership bodies) and ‘foundation’ model (where the trustees are the sole members)

#### Disadvantages

- a CIO can only exist on registration as a charity which may take several months as the process includes assessment of charitable status
- inability to give a public charge over assets might require personal guarantees by trustees for borrowings
- has to be wound up on ceasing to be charity



## Further Issues to be considered when deciding the form of incorporation

In situations where it is not possible to transfer all the charity’s assets unrestricted to a new entity (such as where the charity is wholly a permanent endowment) an alternative is to set up a company limited by guarantee to act as sole corporate trustee. The directors of that trust company have to fulfil their legal duties as company directors, and it is the trust company that must discharge the obligations of charity trustee. However, when permanent endowment transfers to a CIO the CIO automatically becomes able to act as the sole corporate trustee of that permanent endowment.

It may be desirable to retain the unincorporated charity. Charitable trusts can be used as a vehicle to hold buildings and collections separate from the operating company, and associations can become a ‘friends group’ supporting the museum fundraising’s activities, or providing a conduit for the management of volunteer participation. As charitable status carries with it an obligation on an organisation to advance its charitable purposes, it is not permissible to maintain such charities in a dormant state – they must be active.

Both company directors and charity trustees have a legal duty to avoid conflicts of interest. While it might be expected that a parent will have the same best interests as its subsidiaries, this may not be so in every circumstance. It is important therefore that any subsidiary/connected charity has at least some trustees/directors who are not trustees of the parent.

Members of unincorporated associations may be used to working under types of constitution that are designed to enable a ‘one person, one vote’ approach to the organisation’s direction, irrespective of any management committee, which is expected to refer any substantive management decision to the general membership.

Companies and CIOs operate under a different regime, and it is their directors/trustees who have the legal responsibility for general management and direction. Matters specifically reserved to members primarily relate to the stewardship of the entity, in particular the obligation to supply annual accounts and to report to the members, the appointment of external scrutiny of the accounts, and the appointment of trustees. Although members have a right to require a resolution be put to a general meeting, the directors/trustees are subject to the duty to act in the best interests of the charity, and if they collectively feel a members’ resolution is not in the charity’s best interests they are entitled to decline to implement it.

Charitable assets can normally only be transferred to a charity with a similar purpose. This precludes transfer of any part of the assets to any connected trading enterprise that the unincorporated charity may have owned, even if that entity is registered as a Community Interest Company (CIC). The shares invested in any such venture should be transferred to the incorporated charity along with the other assets.

Organisations that operate a defined benefit staff pension scheme should be aware that any change may trigger a demand for payment of any deficiency contributions that may be assessed, especially in the case of a local government pension scheme.

The transfer of a leasehold interest in property may require the surrender of an unexpired lease and might give the landlord the opportunity to terminate the tenancy or vary the terms of the lease in a way unfavourable to the museum.

### ***Transfer of Assets from Unincorporated to Incorporated Charities***

The ‘transfer of assets’ from one owner (such as an unincorporated body) to another (such as a charitable company or CIO) can be more onerous than the process of incorporation itself, especially for an unincorporated organisation that has existing contractual commitments. That museums hold collections tends to require more than the simple exchange of correspondence that might be appropriate to a small charity with modest bank balances, minimal equipment and a couple of minor contractual agreements. The terms of the transfer should be defined within a legally-binding Transfer Agreement between the two parties, to take effect at an agreed time and date.

In addition, the following tasks need to be undertaken:

- the vesting of freehold land and buildings held by the trustees of the unincorporated association in the incorporated entity and its registration or re-registration at the appropriate land registry;
- assignment of leasehold property to the incorporated charity, and gaining landlord’s consent;
- the vesting of permanent endowment;
- transfer of museum collections, other personal property and intellectual property rights;
- the transfer of staff in line with the Transfer of Undertakings (Protection of Employment) Regulations (TUPE);
- opening new bank accounts, re-registering investments and other financial holdings, and transferring funds;
- ‘novation’ (replacing those who signed contracts on behalf of the unincorporated entity to with the new incorporated body) in respect of Agreements with existing suppliers of goods and services, and of any loan agreements relating to the collection;
- registering (as required) the incorporated body with statutory bodies eg HMRC (income tax and national insurance; Gift Aid; VAT etc) and Information Commissioners Office (Register of Data Controllers);
- notifying the Museums Accreditation Scheme;
- advising stakeholders of the change of status;
- advising grant-awarding bodies, transferring responsibility to the incorporated charity, and dealing with any issues arising out of grant contracts;
- soliciting donors to change Gift Aid declarations in favour of the new charity (HMRC will accept that declarations in favour of the ‘old charity’ still remain valid but enabling all givers to sign new declarations might be a means of soliciting larger contributions)
- revising details on the museum’s website (new charity number, and if a company, the company registration number);
- new publicity material providing the new registration numbers;
- new stationery (including invoices) that state the charity status and, if a company, the required information about name, registered office, status, place of registration.

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## Converting a Charitable Company to a CIO

Many smaller charities find dual regulation by both Companies House and the appropriate charity regulator onerous. The only reason for their election to incorporate as companies was that, at that time, there was no alternative. It is now possible for charitable companies to convert to CIOs, without any change in the legal entity. As a result:

- the existing name and charity registration number will be retained;
- no transfer of assets or liabilities is necessary, nor the need for replacement bank accounts;
- all legacies to the charitable company should automatically be payable to the CIO;
- there will no need for new data consents;
- the change should not act as a trigger payment of deficiency contributions to a multi-employer defined benefit pension scheme (though independent advice on this should be taken on this); and
- as there should be no need to transfer employees, typically there will be limited TUPE Regulations implications (though again independent advice should be taken to confirm this).

The consent of the regulator must be obtained for the change, including copies of the Special Resolutions approving the change and adopting the constitution for new CIO (which also has to be supplied).

## Further Guidance

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### Charity Commission for England & Wales

[www.gov.uk/government/organisations/charity-commission](http://www.gov.uk/government/organisations/charity-commission)

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### Office of the Scottish Charities Regulator

[www.oscr.org.uk](http://www.oscr.org.uk)

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### Charity Commission for Northern Ireland,

[www.charitycommissionni.org.uk](http://www.charitycommissionni.org.uk)

### About the author:

Adrian Babbidge has, in one capacity or another, been advising independent museums on governance issues for more than 35 years. He is now semi-retired, but continues to research and write on matters relating to the museums and heritage sector.

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