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9.1. Role of Directors and Members

It is hoped and expected that Community Interest Companies (CICs) will be formed for a wide range of purposes and will vary in size accordingly. What would be an effective form of corporate governance for a large international trading organisation would be quite inappropriate for a small CIC formed, say, to hold the assets of another community organisation. These guidance notes cannot therefore set out a standard governance scheme for all CICs to follow.

9.1.1. Corporate Governance Overview

Company law sets out a number of requirements such as the need for a company to have at least one director to maintain financial and statutory records etc. The essentials are dealt with in the Companies House booklet “Incorporation and Names” and “Life of a Company – Part 1 & Part 2”. The company’s own Articles of Association will also contain detailed governance requirements such as the holding of members and directors’ meetings.

Listed companies are required to report on their compliance with the Financial Reporting Council’s Combined Code on Corporate Governance. There are other codes of corporate governance best practice guidance (such as those issued by institutional investors) which listed companies are encouraged to observe. You should seek professional advice if you are unsure of your obligations in this area. Compliance with the codes etc. (suitably adapted to the CIC’s particular circumstances) is seen as good practice for larger CICs, even if not public or listed; For example, the appointment of independent non-executive directors, audit and directors remuneration committees and the separation of the roles of chairman and Chief Executive would all contribute to the transparency of the organisation and stakeholder confidence.

However, such structures may be disproportionate, costly and unwieldy for smaller CICs but regard should be had to establishing clear structures for the governance of the CIC and in particular the involvement of stakeholders (see Chapter 9.2).

Whatever structure is adopted, it is up to the directors and members to ensure it is complied with and is in the best interest of the CIC and its community. In serious cases, the Regulator has the power to take legal action in the name of the company, but the Regulator is unlikely to be in a position even to consider doing this unless the members, in particular, take their governance responsibilities seriously.

9.1.2. The role of the Director

As with any other company, the directors of a CIC occupy an important position of trust and general company law imposes on them a range of duties to the company and other responsibilities. The directors (and in some circumstances the secretary) are also responsible for ensuring that the company meets its statutory and other obligations. In
some cases the company can hold the directors personally responsible for defaults and can be prosecuted or subject to disqualification proceedings.

In addition to these general responsibilities CIC directors (and, when they take collective decisions about the company, members) are also responsible for ensuring that the company is run in such a way that it will continue to satisfy the community interest test. In practice, this will mean having regard to the interests of the community the CIC is intended to serve, and in some cases giving more weight to those interests than to generating financial returns for investors in the company.

In most companies the day to day management of the company is in the hands of the board of directors although certain functions may be delegated to specific directors, such as the chief executive or financial director, or reserved to the members. As a company gets larger the direct control of daily activities by directors becomes more difficult and functions have to be delegated to employees. It is essential to good governance that the directors clearly establish the lines of delegation. The authority and responsibility of those given delegated power need to be established and systems of control, including where appropriate internal audit, must be set up.

It must be remembered that the term director includes anyone who performs the role of a director whether formally appointed or not. A person who directs the policy and makes major decisions with regard to the company may therefore be regarded as a de facto director or a person upon whose instructions the appointed directors act (excluding those giving professional advice) may be regarded as a shadow director. It is therefore particularly important with CICs where stakeholders are encouraged to participate in running the organisation to clearly establish people’s respective roles (see Chapter 9.2).

It is also important not to take on the role of director lightly; it is not a matter of status but a commitment to take on an important role and obligations. In particular, it should be noted that, while it is often a good idea to have “non-executive” directors, who do not work full-time in the business, but who have particular skills and experience and can contribute an independent perspective to the management of the company, if things go wrong (particularly if they have not performed their duties diligently) they may well be held equally liable for any consequences with the “executive” directors.

### 9.1.3. Members

In a company limited by shares the members are usually the shareholders subject to the provisions included in the Articles of Association. In a company limited by guarantee the members are usually the subscribing guarantors and others admitted to membership according to the Articles of Association.

Although the day to day running of the company may be delegated to the directors, subject to company law and the Articles of Association of the company, the ultimate control of the CIC and responsibility for major policy and other decisions rests with the members. The general meeting of a company’s members is its ultimate decision-making body, and members have statutory rights to require the company to call such meetings.
For example, they can appoint and dismiss the directors, delegate powers to the directors, declare dividends, approve major transactions and change the constitution of the company (see Chapter 5).

In all companies, but more so with CICs, members should not regard delegation to directors as being the same as abdication of responsibility. It is important that the members should monitor the performance of the CIC and the directors, for example, to satisfy themselves that the company continues to meet the community interest test and fully involves the community in its activities and development.

As explained further in Chapter 11, the light touch regulatory regime operated by the Regulator means that, to a large extent, the Regulator relies on others to bring to the Regulator’s attention any matters causing concern about the activities of a CIC. The members clearly have a role to play in drawing such concerns to the attention of the Regulator who will consider whether the Regulator should take any action.
9.2. Relationship with other stakeholders

Like all other companies CICs will have a number of stakeholders such as members, directors, employees, customers etc, but it is an important principle that a CIC should have particular regard to its major stakeholder i.e. the community, which is intended to benefit from its activities.

The concept of the community is discussed in Chapter 2 and the CIC Report has to show specifically what the CIC has done to benefit the community and how it has consulted those affected by its activities and the outcome of such consultation (see Chapter 8).

The involvement of stakeholders should therefore be integrated in the corporate governance of the CIC. The extent of this will clearly vary according to the size, purpose, geographical extent etc of the CIC and the cost needs to be proportionate to the scale of the operation.

The provision of adequate information is clearly the starting point for the consultation process together with the provision of easily used methods of feedback.

This can be achieved by simple methods such as circulating newsletters and holding stakeholder meetings or more sophisticated methods such as setting up a website with dialogue facilities or issuing formal consultation documents before taking a major policy decision. Alternatively, stakeholder groups can be given official standing under a company’s constitution (for example, by requiring that they are consulted before the directors or members make certain types of decisions).

Other stakeholders could be included with the members in the circulation of the company annual report and accounts and invited to attend an open forum linked to the company’s annual general meeting.

In many organisations the setting up of user and advisory groups or a club committee separate from the board of directors can be an effective way of bringing stakeholders into the running of the organisation. As discussed in Chapter 9, however, it is important to clearly distinguish the respective roles and responsibilities of the directors and others involved in running the organisation. Stakeholders who are very influential in the affairs of a CIC may find that they have become “shadow directors” – a status which can attract the same liabilities as those of directors in some cases.

A wide view should be taken of who may be affected by your activities and should include not only those who currently benefit but also potential beneficiaries. You should also consider those indirectly affected such as the other residents of the area of your operations.
9.3. Directors’ remuneration

9.3.1. Key points

The remuneration of directors is an important and sometimes controversial area of company policy. As far as CICs are concerned, the key points are as follows:

- Directors may be paid for their services to a CIC.
- CIC directors’ remuneration should never be more than is reasonable.
- CIC directors’ remuneration arrangements should always be transparent.
- The Regulator – or the members of a CIC – may take action if a CIC director’s remuneration appears to be too high.

These principles, and the background to them, are explored further below.

9.3.2. CIC Directors may be paid for their services.

CICs will come in many different shapes and sizes. However, many CICs will be actively trading businesses that need good directors if they are to be successful. Such CICs will usually need or wish to remunerate their directors in order to ensure that they achieve their full potential to benefit the community.

For some individuals, being a director of a successful CIC may be sufficient reward in itself: such individuals either may not wish to be remunerated at all (e.g. if they are not involved in the day to day running of the business), or may wish to receive a salary which is not significantly larger than that of non-director employees. Equally, some CICs will be less commercially active than others. Some may be akin to clubs or voluntary organisations and their ethos and purpose may mean that their directors are part-time and unpaid, or paid only token amounts – for example, a CIC that was formed simply to act as a custodian of community assets, such a sports facility, might not need, or find it appropriate, to remunerate its directors.

On the other hand, it is to be expected that many CICs will have good reason to wish to remunerate their directors. In particular, the salaries paid to the directors of the more dynamic and socially ambitious CICs will reflect their need to attract individuals who combine a high degree of commercial flair and social vision.

There is no legal or policy reason why the remuneration of any CIC’s directors should not fairly reflect the value of their skills and expertise to the company’s business and the community that it exists to serve.

In this connection, the Regulator has stated:
“I want CICs to be able to attract high quality wealth creators as directors, paying them reasonable salaries, giving them immense job satisfaction, and the opportunity to put their talents to making profits for the public good.”

However, as explained below, the remuneration of CIC directors is subject to a number of potential constraints, both as a matter of general company law and good corporate governance, and because of the particular characteristics of the CIC form.

9.3.3. General company law rules in relation to director’s remuneration

Before considering CIC-specific constraints on directors’ remuneration, it is worth noting some of the rules that apply to remuneration of all company directors.

If it is intended that the directors of your CIC should receive remuneration (i.e. a benefit in return for their services to the company which goes beyond payment of their out of pocket expenses), you will need to ensure that there is legal authority to pay them at all. In an ordinary company, directors are only entitled to be remunerated for their services as directors if such remuneration is approved by the members or provided for in the company’s Articles of Association.

It is possible that the remuneration of CIC directors could be authorised simply by a resolution of the company’s members, not backed by provision in the company’s Articles of Association. However, this could well be controversial in some cases and the Regulator strongly advises any CIC which contemplates remunerating its directors to include express provision for such remuneration in its Articles of Association.

Such provisions normally assign the responsibility for determining the level of each director’s remuneration either to the members or to the directors themselves. (The Articles of Association will generally provide that individual directors may not vote on their remuneration or other terms of their service contracts with the company, reflecting directors’ general duty to avoid conflicts between their own interests and those of the company.) Another possibility is to require that any directors’ remuneration arrangements agreed by the directors has to be approved by the members. Sample clauses on directors’ remuneration (and a definition of “remuneration”) are included in each of the model constitutions for CICs.

As regards the level of directors’ remuneration, the directors or members do not have an entirely free hand – even if the provisions authorising remuneration of directors are expressed in broad, discretionary terms (e.g. “such remuneration as the directors / members shall determine”). Even in a non-CIC company, a variety of considerations must be taken into account before directors’ remuneration is decided.

For example, in any company there is a balance to be struck between the need to reward directors for their contribution to the company’s success and offer incentives to continue to give excellent service to the company, and the impact which directors’ salaries may have on the financial position of the company, or on other aspects of its performance or reputation.
There are legal as well as commercial reasons for ensuring that an appropriate balance is struck in this respect. Directors deciding on remuneration, as on any other matter, must act in the way that they consider is most likely to promote the interests of the company as a whole. In most companies, the interests of the company as a whole are identified primarily with the interests of its members. However, in companies like CICs, which are established wholly or partly for purposes other than the benefit of their members, directors must also act in the way that they consider, in good faith, is most likely to achieve those other purposes.

What these general principles are likely to mean in the context of individual CICs is explored further below in the section on factors to be considered in determining the reasonableness, or otherwise, of directors’ remuneration.

9.3.4. The community interest test, the asset lock & remuneration

Two aspects of the legal framework which applies specifically to CICs, and not to other companies, are of particular importance in relation to directors’ remuneration: these are the community interest test and the asset lock.

The community interest test requires CICs to conduct their affairs in such a way that a reasonable person might consider that their activities are being carried on for the benefit of the community. The legislation also provides that a CIC, which carries on activities that a reasonable person might consider only benefit its own employees, will not satisfy the community interest test.

These rules apply as much to the remuneration of directors as to any other area of a CIC’s business. For example, a CIC does not satisfy the community interest test if it is ostensibly established to benefit the community by devoting the profits from its trading activities to charitable or other community causes, but in fact consistently sets its directors’ remuneration at a level which means that the company is left making little or no profit for distribution to these good causes.

The asset lock is the mechanism that ensures that a CIC’s assets are used for the benefit of the community. It is embodied in the requirement that every CIC must include in its Articles of Association a prohibition on transferring any of its assets other than for full consideration (subject to certain limited exceptions, such as gifts to charities or the payment of dividends subject to the dividend capping rules).

In the context of directors’ remuneration, consideration means the value which the company (and through it, the community) gets from having a particular individual as a director in return for transferring some of its assets to that individual by way of remuneration. Put simply, if a CIC pays its directors more than they are really worth to it and the community that it serves, it may well be breaching the asset lock. Such a breach may give rise to legal action (see further below).
9.3.5. Charitable trustees as directors of a subsidiary trading company

Please refer to the guidance on the Charity Commission’s website.

People who are trustees of a charity often become directors of a subsidiary trading company (including a CIC) owned by that charity. Clearly there may be some need for the trustees to be represented on the board of the subsidiary trading company. There are however difficulties if all the trustees become directors of the trading company, or if all the directors are trustees.

An individual who is both a trustee of the charity and a director of a subsidiary trading company will have two different sets of responsibilities to fulfil even though the company was established as a means of raising funds for the charity. It can be difficult to balance these responsibilities.

The Charity Commission and the CIC Regulator recommends that there should be at least one person who is a trustee of the charity and not a director of the trading company, and at least one person who is a director of the trading company and not a trustee of the charity. The people without dual interests can be expected to give suitable advice to their colleagues as to the proper course of action in a conflict of interest situation and this should reduce the risk that any transaction between the charity and the CIC being challenged or questioned.

9.3.5.1. Payment of a charity trustee for services as a director

A charity trustee cannot be paid for his services as a director, or employee, of the subsidiary trading company (or, of course, as an employee or trustee of the charity) unless the governing document of the charity specifically provides for this.

For further information please contact the Charity Commission or alternatively for all general enquires telephone 0845 3000 218. Click on the following link for more information about trading as a subsidiary company/CIC of a charity.

9.3.6. What is “reasonable” remuneration?

It is clear that, as a general principle, the remuneration of CIC directors should be no more than is reasonable having regard to the contribution which they make to the success of the company and the benefits it provides for the community. The overall contribution which a director makes to the success of a CIC’s business and the attainment of its community benefit objectives is a key consideration when determining whether that director’s remuneration is consistent with the Asset Lock.

There is, of course, no mathematical formula for calculating the “correct” level of remuneration for any given director of any given CIC. Rather, the range of remuneration levels which may be considered to be reasonable will depend in each case on a variety of factors. The mix of factors, and the weight attached to each of them, will vary, but it is possible to identify a number of considerations which CICs should generally bear in mind when setting directors’ remuneration, and these are outlined below.
9.3.6.1. Particular responsibilities, skills and expertise of individual directors

Considerable weight should always be given to the nature of the basic services which the director is expected to perform for the company. Relevant factors will include the extent to which the director is actively involved in the day to day running of the company; the areas of the company’s business for which the director is given particular responsibility and any particular skills or expertise necessary to manage those aspects of the business (e.g. the qualifications necessary to be a finance director); and the number of employees the director is responsible for managing.

9.3.6.2. Nature, size and performance of the company’s business

A wide range of different organisations adopt the CIC form, each with different aims and aspirations. CICs vary widely in size (measured by assets, turnover or employee numbers) and the kinds of business they are involved in (some are highly commercial organisations operating in intensely competitive markets, others are non-profit making organisations which have more in common with charities than public companies).

Both the size of a CIC and the nature of its business will be relevant to determining what amounts to reasonable remuneration for its directors (and evidence about the comparative remuneration of directors and managers in other similar organisations, either in the private or the public sector, will provide a strong guide to whether remuneration in a particular CIC is within a reasonable range). Broadly speaking, the larger and more commercial a CIC is, the greater will be the levels at which it may be reasonable to remunerate its directors.

As a matter of general law, there is no reason to insist that a CIC must be making a profit before directors can be remunerated, or remunerated at a particular level. However, the performance of a CIC’s business will often be relevant, in one way or another, to determining how much its directors should be paid. For example, directors may be offered incentives by the payment of a bonus if certain financial targets are reached. It will be for a CIC itself to determine by what yardstick it wishes to measure its performance for these or any other purposes: conventional measures of profitability, for example, may not always be considered an appropriate way of assessing how successful a CIC has been at benefiting the community it serves.

9.3.6.3. Financial position of the company

The desire to reward or provide incentives for individual directors must be balanced against a consideration of the impact which their remuneration may have on the financial health of the company in both the short and the long term. If the company is or may soon be in financial difficulties, it may be appropriate to adjust the level of directors’ remuneration downwards. But this will not always be the case: good managers are needed just as much in bad times as in good (if not more so), and if suitably qualified directors are not retained or recruited, there may soon be no company left to run.

Conversely, while good financial results may mean that there is plenty of money available to remunerate directors, large profits may not be a reason for large directors’ bonuses if the directors concerned have not contributed significantly to the company’s profitability.

9.3.6.4. Published guidance on good corporate governance

Listed companies are encouraged or required to observe various codes of practice or sets of guidance on corporate governance issues (such as the Combined Code on Corporate
Governance, or the European Commission’s recommendation of 14 December 2004 on fostering an appropriate regime for the remuneration of directors of listed companies. These codes and sets of guidance generally contain provisions about directors’ remuneration.

In addition, investors in such companies also often follow guidance on remuneration issued by bodies such as the Association of British Insurers, which may affect the way in which they vote at general meetings on remuneration issues.

Although these codes and sets of guidance have been devised primarily with listed companies in mind, they may also provide good models of best practice for non-listed CICs, particularly non-listed community interest public limited companies and the larger private CICs.

9.3.6.5. Views of stakeholders

It will often be appropriate to seek stakeholder approval of directors’ remuneration. Formal examples of such approval would include the company’s members voting in a general meeting to approve individual directors’ remuneration arrangements. Less formal kinds of approval might be found where, for example, key stakeholder customers of a CIC (for example, a community organisation which is the main beneficiary of its activities) have expressed themselves to be content with the directors’ remuneration arrangements.

If the arrangements for directors’ remuneration have been approved by stakeholders, there may be a presumption (but no more than a presumption) that those arrangements are reasonable. However, it should be noted that:

- Any such approval will only be strong evidence of the reasonableness of the remuneration concerned if the details of that remuneration were completely transparent to stakeholders when they gave their approval; and

- Any presumption that remuneration arrangements approved by stakeholders is reasonable is likely to be stronger where the stakeholders concerned do not stand to gain financially as a direct or indirect result of those arrangements (e.g. if the CIC is limited by guarantee and the stakeholders concerned are its members).

9.3.7. Transparency

All CICs should be as transparent as possible about their directors’ remuneration. No effective control can be exercised over the remuneration of directors unless directors’ remuneration arrangements are transparent.

All CICs are obliged to disclose certain details about their directors’ remuneration as part of their annual CIC Reports. Larger CICs whose shares are publicly traded will be obliged to make further disclosures in a more detailed directors’ remuneration report filed as part of their annual accounts – your CIC’s accountant will give you further guidance on these requirements.

In addition, all companies are required to keep copies of directors’ service contracts, or memoranda of their terms, available at an appropriate place for inspection by their...
members. Certain long term contracts and arrangements for payment on loss of office require the approval of members and must not be entered into unless they have approved them.

However, particularly in the context of establishing stakeholder buy-in to directors’ remuneration arrangements (see above), there may well be cases in which the Regulator would regard it as best practice for CICs:

- To disclose more detailed information about individual directors’ remuneration than they would be required to disclose by law;
- To disclose such information more widely or directly than they would be required to do by law; or
- To seek members’ approval of matters of which they would not required by law to seek their approval.

Depending on the circumstances, it may be appropriate for CICs to take such action either proactively as a matter of general policy, or in response to particular questions or suggestions from stakeholders.

### 9.3.8. Action by the Regulator

As noted above, the award of excessive remuneration to a CIC’s directors could amount to a failure to satisfy the community interest test, a breach of the asset lock, a failure to comply with the company’s Articles of Association, or a breach of one or more of the directors’ general duties to the company – any of which could give rise to legal action by members.

If the Regulator becomes aware of potentially excessive director remuneration, the Regulator is likely to wish to discuss the matter further with the CIC concerned. If the conditions for the exercise of the Regulator’s supervisory powers are met, the Regulator may also wish to exercise the Regulator’s formal powers of investigation or audit, and if it appears that the level of remuneration being awarded to a director is legally unjustifiable, the Regulator will consider taking one or more of the forms of enforcement action which are open to the Regulator (including bringing proceedings in the name of the company against a director for breach of duty, or ordering the removal of a director).

However, it should be emphasised that it is not the Regulator’s (or the Court’s) function to second-guess commercial or other judgements made in good faith by the directors or members of a CIC about directors’ remuneration, and that the exercise of the Regulator’s powers in this area is a remedy of last resort. The primary discipline on CIC directors’ remuneration arrangements should be transparency and stakeholder influence or approval.
9.3.9 Directors’ payments and benefits and Tax returns

You must complete a tax return if you are a company director (unless your company is a not for profit company and you do not receive any payments or benefits). Please refer to the [HM Revenue & Customs website](https://www.gov.uk) for further details.