

Charity Finance Group Digital Workshop

Charity Financial Governance and trustee responsibilities

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Now, for tomorrow



What this session will cover:

- The Kids Company case - what was decided?
- What lessons can be learned?
- Risk management
- Charity reserves
- Financial governance
- Trustee assurance from auditor interaction
- Trustee performance



Key issues at trial

- Was Camila Batmaghelidjh a de facto director?
- **Conclusion:** No
 - Significant influence but not part of the ultimate decision-making structure
 - Not on an equal footing with the trustees and did not have the same, or equivalent, status or functions
 - Not equally able to participate in decision making at the highest level
 - Accountable to the trustees and subject to their supervision and direction

Key issues at trial

- Were the directors '*unfit to be concerned in the management of a company*'?
- Main allegation: the directors caused and/or allowed Kids Company to operate an unsustainable business model
- No allegation of dishonesty, bad faith, inappropriate personal gain or any other want of probity

Unsustainable business model allegation

- Demand-led model of self-referral and a policy of never turning a child in need away
- Dependence on ad hoc grants, donations and loans
- Inadequate action to alter business model in context of rapid and uncontrolled growth and increasing financial difficulties
- Inadequate governance or control by the trustees of dominant CEO, resistant to change
- Trading at an increasing deficiency of income to expenditure
- Relying on overoptimistic statutory funding projections
- Failing adequately to consider risk caused by 'donor fatigue'
- Failing to build up reserves
- Inadequate action to oversee and scrutinise expenditure on clients, test adherence to policies or consider any need to adjust them
- Inappropriately treating certain items as accruals
- NB. No challenge of any particular item of expenditure. Question was whether policies and procedures were followed, and overall budgeting of costs

Judge's findings

- Potentially high risk enterprise but model not unsustainable
- Not simply dependent on small pool of donors and ad hoc donations
- Until Nov 2014, trustees satisfied sufficient funds could be raised, based on experience of prior years plus auditor comments that “*income levels for 2014 look healthy and also achievable*”)
- Valid criticism that expenditure allowed to be incurred, and increase, without income having been secured to allow prompt payment of creditors
- Not demonstrated that trustees ought to have been aware model was bound to fail
- Trustees' expectation of support from government and philanthropists not unreasonable
- Trustees entitled to rely on expert staff (particularly finance staff)
- Absent unfounded allegations of sexual abuse, more likely than not that restructuring would have succeeded and therefore charity would have survived
- [Reserves – see below]
- Trustees not unfit

Judge's findings - reserves

- Some validity in a criticism of absence of liquid reserves
- Creating them much easier said than done
- Would have diverted resources from meeting increasing need that charity existed to serve
- No legal requirement for reserves
- Not having reserves might increase the risk of failure but absence didn't make model unsustainable
- Reserves equivalent to three months' operating expenditure ... (understood to be uncontroversial aspiration) would have been well short of what was required to ensure survival

Judge's findings: the trustees and their decisions

“The decisions they made were matters of honest judgment, made in difficult circumstances in what they thought were the best interests of the charity. The Official Receiver has not demonstrated that decisions that the Trustees took, or failed to take, in the factual context were outside a range of reasonable decision-making, and in my view the Trustees’ conduct does not amount to incompetence of a high degree”

“...this is a group of highly impressive and dedicated individuals who selflessly gave enormous amounts of their time to what was clearly a highly challenging trusteeship. I have a great deal of respect for the care and commitment they showed, and the fact that they did not take the much easier path of not getting involved in the first place or walking away when things got difficult.”

“Most charities would, I would think, be delighted to have available to them individuals with the abilities and experience that the Trustees in this case possess.”

Comments from auditors

“I think there was [a rigorous financial culture]. They had a qualified director of finance, they had a qualified head of finance, and they had a more than adequate financial manual. I think the financial controls as we checked them were more than adequate for an organisation of that size.”

- Auditor to PACAC Inquiry

Comments from auditors

- *“There are comprehensive policies and procedures at the charity.” (minor recommendations for improvement identified)*
- *“The governance system in place at the charity appears to be appropriate for its size and complexity.”*
- Management accounting: *“regular reporting of performance to Trustees through the Board and Finance Committee”* (recommendations made to *“further improve the information provided”*)
- Financial systems: given the *“wide range”* of income and expenditure there were *“reasonable controls over the systems capturing and reporting income and expenditure”* (recommendations made to strengthen controls)
- Forecasting: *“Both strategy and business planning are appropriately managed, however, this must be considered in light of the serious cash flow position that the Charity often finds itself in.”*
 - March 2014 report from large audit firm

Charity Commission Criticisms

- Operated a high risk business model
- Expenditure increased without secure income or adequate reserves to cover costs
- Lack of / destruction of some records
- Insufficient evidence of decision making re: some payments so couldn't conclude if justified or made in best interests of the charity
- Might have helped more if expenditure on top 25 reduced
- Should have built up more reserves
- Didn't always pay creditors on time - mismanagement
- CEO had been in post for a long time
- Chair had been in post for a long time (12 years)
- Nobody on the board with clinical experience

Charity Commission Lessons for Wider Sector

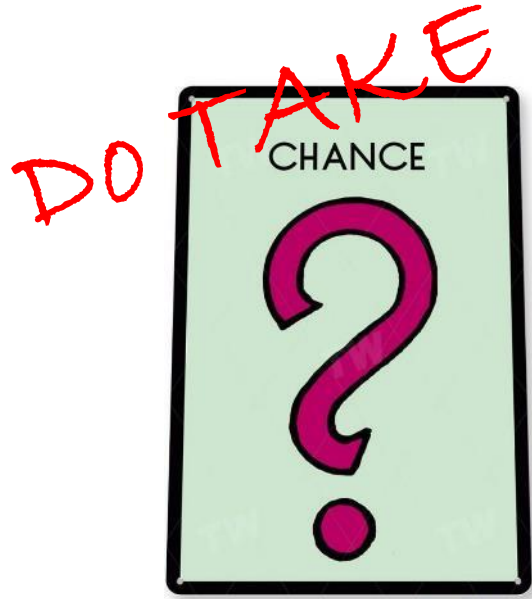
- Ensure checks and balances - and right blend of skills and knowledge - in place, to avoid power imbalances
- Board rotation – longer terms should be exceptional
- Diversity – in all its forms – leads to better decision making
- Identify and balance risks associated with innovative operating models
- Measuring impact should be part of evaluating whether (esp. innovative) approach is effective
- Make well-rounded and appropriate decisions about approach to reserves
- CC encourages all funders to contribute to core costs, inc. building reserves
- Ensure infrastructure, governance and resources keep pace with growth
- Regularly review and assess risks in all areas of work and plan for management of those risks
- Create closure contingency plans

TRUSTEE



MONOPOLY

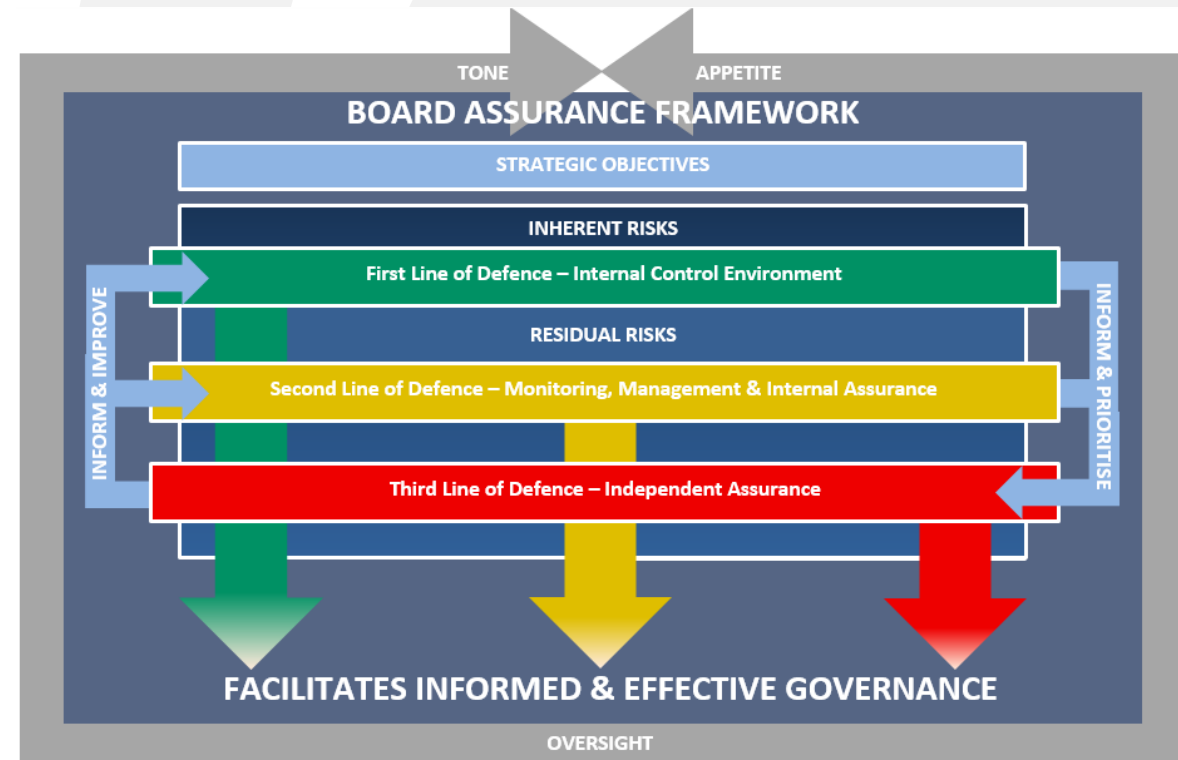
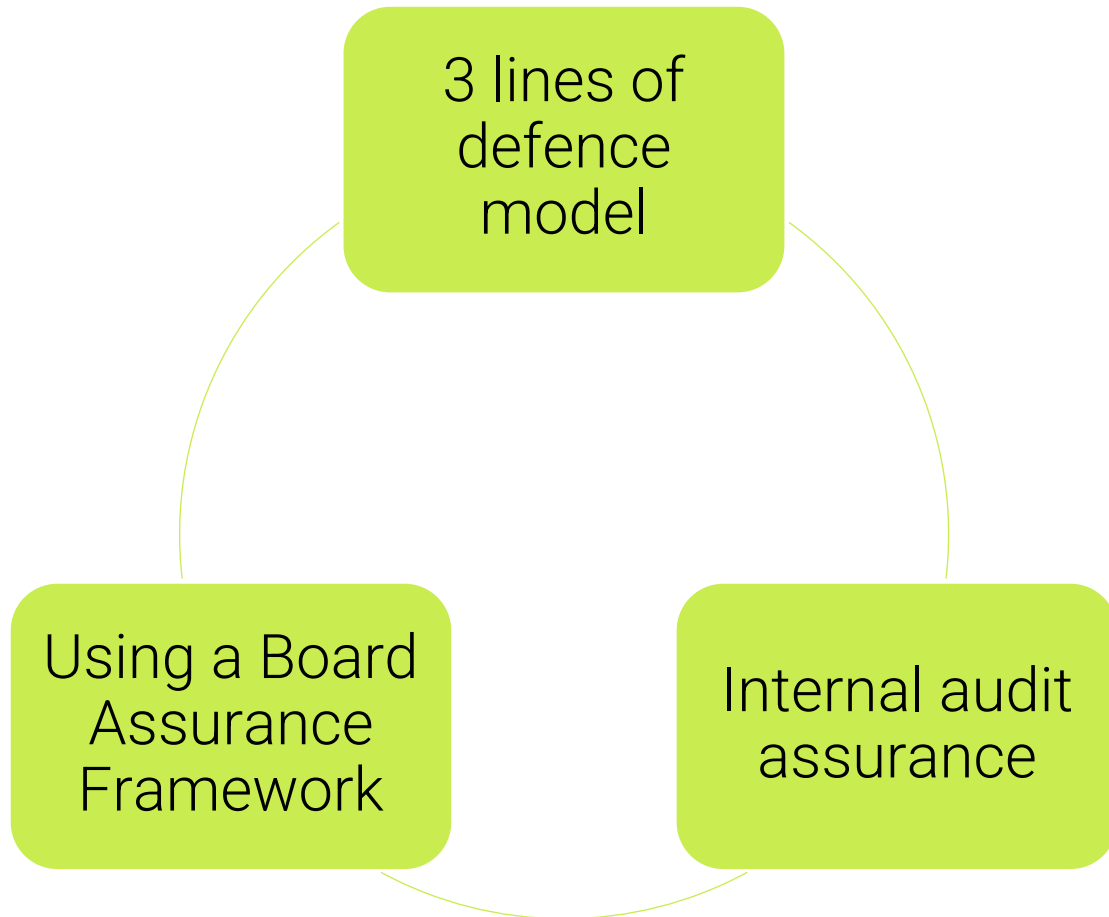
BRAND





- ? The importance of good risk management
- ? What is an unsustainable business model?
- ? Unexpected crashes or gradually weakening foundations?
- ? Is high risk to be avoided and trustee prudence considered a virtue?
- ? Note and articulate risks
- ? Mitigation and stress testing of models

Going beyond traditional risk management frameworks



The need for charity reserves



CC Guidance (CC19): Building Resilience

Trustees should develop a reserves policy that:

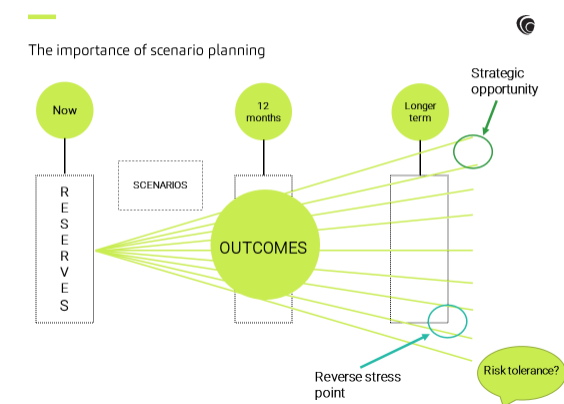
- fully justifies and clearly explains keeping or not keeping reserves
- identifies and plans for the maintenance of essential services for beneficiaries
- reflects *the risks of unplanned closure* associated with the charity's business model, spending commitments, potential liabilities and financial forecasts
- helps to address *the risks of unplanned closure* on their beneficiaries (in particular, vulnerable beneficiaries), staff and volunteers

£ Charities often uncertain how to justify an appropriate level of reserves

£ Often linked to reserves for forced winding up – 3 months commonly used; often likely to be insufficient

£ Hold reserves against turbulence not fatal crashes

£ Complex situations - Charity insolvency; use of restricted funds; wrongful trading



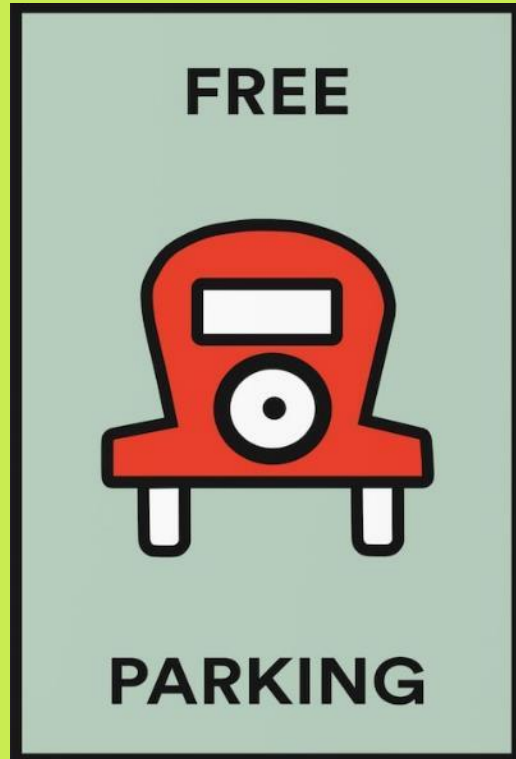
Making your charity as safe as houses



- ❖ Financial resilience and reserves is only part of safety net
- ❖ Critical Incident Plans
- ❖ Business continuity
- ❖ Organisational resilience assessment

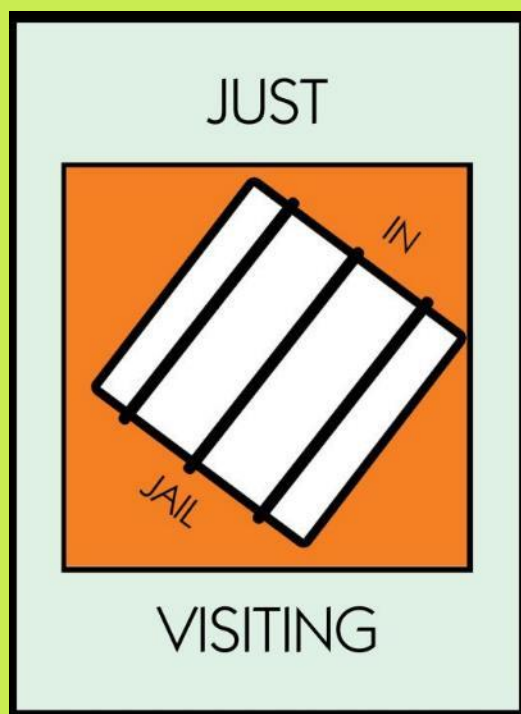
- Understanding and protecting your critical activities, services and processes
- Determining risk appetite for each risk area
- Protection of brand and reputation
- Better quality data and reporting
- Heightened awareness

Effective financial governance



- ✓ Are you spending enough time and money on financial management and governance?
- ✓ Is there sufficient engagement by people throughout the charity? Trustees/ senior leaders
- ✓ Is there full integration of board policies and business units?
- ✓ No them and us?
- ✓ Finance professionals responsibility to engage other senior leaders and the board appropriately
- ✓ Do you have strong long-term business and financial models = scenario planning, reverse stress testing etc
- ✓ Consider the benefits of a unitary board structure

Interacting with your auditors



- ✦ Is your interaction just an annual compliance exercise?
- ✦ Auditor's warnings – when to take note
- ✦ Appointing a specialist – how to recognise when you see one?
- ✦ If auditor has specialist knowledge and competency – take heed, ignore at peril!

Trustee on-boarding

- 👤 Trustees almost always – highly motivated and committed
- 👤 Chosen due to skills and experience
- 👤 Little induction and training on appointment or subsequently
- 👤 Seldom have buddies or mentors
- 👤 But are awareness levels as high as possible?



Charity Governance Code states:

It is the Code's starting point that all trustees:

- *are committed to their charity's cause and have joined its board because they want to help the charity deliver its purposes most effectively for public benefit*
- *recognise that meeting their charity's stated public benefit is an ongoing requirement*
- *understand their roles and legal responsibilities, and, in particular, have read and understand: the Charity Commission's guidance The Essential Trustee (CC3) and their charity's governing document*
- *are committed to good governance and want to contribute to. their charity's continued improvement*

A Few Insolvency Issues

- Solvency tests
 - Cash flow
 - Can the charity pay its debts as they fall due?
 - Balance sheet
 - Assets worth more than liabilities?
- Wrongful trading (for companies and CIOs)
 - If you know (or ought to know)
 - There is no reasonable prospect of avoiding insolvent liquidation
 - You must take all steps to protect the interests of creditors
 - Switch of duties from purpose to creditors
- Preferences and transactions at undervalue
- Using restricted funds

Questions?



Further resources

MHA

<https://www.mha.co.uk/spotlight-on/trustee-hub>

Bates Wells

<https://bateswells.co.uk/updates/governance-building-blocks-for-charities/>

ICAEW

<https://www.icaew.com/technical/charity-community/trustee-training-modules>

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