Kids Company inquiry - what your charity needs to know

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The Charity Commission's recently published inquiry report into the running of 'Kids Company' prior to its abrupt closure back in 2015 underlines for all charities the importance of:

- Ensuring their financial planning and approach to reserves are properly and appropriately considered
- Having in place operating models that reflect the nature and scale of a charity
- Keeping their board fresh and diverse with the right mix of skills and experience

In this briefing, we look at the Charity Commission's findings, how they differed from the decision of the High Court and what other charities can learn from them.

What was the inquiry about?

'Kids Company' ('the Charity') was set up to support deprived children and young people, working in challenging circumstances with extremely vulnerable beneficiaries. The Charity was supported by a number of high profile individuals, as well as receiving millions of pounds in government funding.

The Charity operated a 'demand-led' model and continued to grow year-on-year, relying on donations, government grants and short-term loans and ploughing all its funds into the delivery of services rather than building any significant reserves, leading to a precarious financial position.

The Charity was planning to address this via a restructuring plan in 2015, but adverse media publicity and what turned out to be unfounded allegations of abuse at the charity caused donors to withdraw and - with no real financial cushioning to fall back on - the Charity very publicly folded.

Given how high profile the Charity was and the extent of government backing it had received, there then ensued a string of investigations and reports into what had happened, plus High Court proceedings brought by the Official Receiver under the company directors disqualification regime alleging that the Charity's directors were unfit by virtue of incompetence for having allowed the Charity to operate an unsustainable business model. Those proceedings culminated last year in a High Court decision which exonerated the Charity's trustees from any wrongdoing.

The Charity Commission opened a statutory inquiry into the Charity in 2015. This was put on hold pending the other investigations, but has now concluded with the publication of its inquiry report.

What did the Charity Commission find?

The inquiry looked at the governance and financial management of the Kids Company, including whether its trustees had complied with their duties under charity law. As such, the focus of the Commission was different from that of the High Court. While the High Court had focused on whether the trustees were fit to be concerned in the management of a company, the Commission was looking at the duties of charity trustees under charity law, which explains why the view of the Commission differed in some respects.

The Charity Commission did, however, agree with the High Court that there had been no dishonesty, bad faith or inappropriate personal gain in the operation of the Charity and found that the legal test was not met for it to commence its own disqualification proceedings against the trustees or CEO.

However, the inquiry report was critical of the Charity's trustees in a number of respects, with the main points as follows:

- *Operating model sustainability* - The Charity Commission found that the combination of heavy reliance on grants and donations and on a key fundraiser (the CEO), plus low reserves and a demand-led service, meant the Charity was operating a high-risk business model, which was unusual for a charity of this size. Whilst the High Court had ruled that the decision to prioritise spending on charitable objects over building up financial reserves was one the trustees could reasonably reach, the Charity Commission's view was that, by maintaining insufficient reserves, the trustees were risking the Charity being more vulnerable to external and variable pressures. This risk had previously been pointed out to the trustees by the Charity's auditors and it would have been 'prudent' for the Charity to seek to build up reserves in case of unexpected expenses or an unexpected fall in income, which may have enabled it to 'weather the storm' and therefore ensure ongoing support for its beneficiaries.

- *Financial mismanagement* - Cash-flow issues at the Charity meant that it failed to make some payments to HMRC on time, resulting in warning letters from HMRC, negotiations with HMRC and part-payment of debts. In addition, payments to some workers were not made on time. The Charity Commission found that this repeated pattern of failing to make payments to creditors illustrated the financial difficulty the Charity was in and the failure to manage this effectively, concluding that this amounted to mismanagement by the trustees in the administration of the Charity.

- *Board make-up/governance* - Kids Company grew quickly - almost tenfold in the space of a decade - and the Charity Commission was of the view that it would have benefitted from recruiting to the board someone with experience of running a large, complex charity, who could bring in new ideas and share good practice. With the chair of trustees at the Charity having been in post for over a decade and the CEO since it was founded, the inquiry report also highlighted that the introduction of new trustees would have enabled long-established practices to be reviewed and the status quo to be challenged more effectively.

Key learning for other charities

The Charity Commission's report sets out a number learning points for the wider charities sector to take on board, including:

- Given the need for charity boards to remain fresh and diverse, consider setting an agreed term of office for trustees, to avoid complacency and bring in new perspectives. Trustees, including the chair, may also want to consider rotating their roles.
- Although there is no 'best way' for charities to deliver public benefit and innovative models can help keep the sector relevant and dynamic, trustees must remember their duty to manage their charity and its recourses effectively and prudently and will need to identify and manage the risks involved in their charity's operating model, including risks from over-dependence on any particular source of funding.
- There is 'no single level of reserves that is right for every charity', but charities are reminded that a low level of financial reserve may mean limited resilience against cash-flow problems or increased demand - research by the Charity Commission found that 40% of charities have drawn on reserves in responding to the challenges presented by the COVID-19 pandemic. All charities must explain their approach to reserves in their annual report.
- If planning expansion, charities must make sure that their infrastructure, governance and resources keep pace with their growth, including ensuring there is a sustainable income source to support it.

Much of this is not new, but reinforces some of the fundamentals of good governance for charities.

Our charity lawyers have significant experience of advising charities on all aspects of charity law and governance and can answer any questions you may have resulting from this inquiry or otherwise in relation to your charity's governance and compliance arrangements.

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