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Charities Alert

The collapse of Kids Company: lessons to be learned

The full parliamentary report is available at: http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubadm/433/433.pdf

In a nutshell

The high profile collapse of Kids Company in August 2015 has been the subject of an inquiry by Public Administration and Constitutional Affairs Committee (PACAC) of the House of Commons. The PACAC report published on the 1 February 2016 draws out lessons for charity trustees, professional firms, the Charity Commission and Whitehall. This briefing highlights some of the key lessons and recommendations with a particular focus for trustees. Some of the main issues identified by PACAC include:

- Kids Company relied on a hand-to-mouth existence and by refusing to prioritise the building of any significant reserves, the trustees failed to exercise their duty of care towards the charity's clients, employees and donors. (Paragraph 22[1]).
- Kids Company did not have a clear plan to manage cash flow ups and downs but relied on fundraisers and government to make up shortfalls (paragraph 25).
- Kids Company over-inflated figures relating to its caseload. Trustees were either ignorant of this exaggeration or simply accepted it, because it helped to promote the charity's fundraising (paragraph 35).
- Kids Company did not respond to Ofsted concerns (paragraph 40).
- PACAC found it "difficult to see on what basis Kids Company's trustees satisfied themselves of the appropriateness of support given to clients, and the value for money offered by the charity's high resource model…This approach left the trustees unable to defend the reputation of Kids Company which is a prime obligation of the good governance and leadership of any organisation" (paragraph 47).
- The handling of an allegation of a very serious failure in safeguarding was inadequate and irresponsible (paragraph 59).
- There was a lack of relevant trustee expertise in the field of youth services and psychotherapy (paragraph 68).
- There was a clear link between the failure to correct serious weaknesses in the organisation, and the failure to refresh its leadership (paragraph 68).
- No changes were made in response to management letters from auditors and repeated warnings about the charity's low levels of reserves and Kids Company's extensive use of contracted and self-employed workers despite concerns being raised with trustees (paragraph 74).
- There should be particular caution towards boards in which trustees have held their positions for more than two terms, and towards boards where no individuals have experience in the charity's particular area of delivery (paragraph 162).

1 Paragraph references refer to the House of Commons Public Administration and Constitutional Affairs Committee report published 1 February 2016 The Collapse of Kids Company: lessons for charity trustees, professional firms, the Charity Commission, and Whitehall.

Background

Keeping Kids Company (known as Kids Company) was founded in 1996. It obtained its first public funding from the New Opportunities Fund in 2000 and its first bailout in 2002 with a cross government financial rescue package of £300,000. Over the course of its existence government provided grants of at least £42m. Following a very public collapse in the summer of 2015 the Public Administration and Constitutional Affairs Committee (PACAC) commenced an inquiry which concluded in January 2016 and the report was published on 1 February 2016. It draws out lessons for charity trustees, professional firms, the Charity Commission and Whitehall, identifies the causes of the collapse and makes recommendations.

The trustees

"We advise charities to spend their money but at the same time they must have adequate reserves" – William Shawcross, Chair of the Charity Commission

Reserves

Kids Company argued that their demand-led model meant that the charity always operated on a very low level of reserves. This low level of reserves was repeatedly mentioned in management letters from the auditors and recognised by the trustees as an issue. However, the investigation found that these warnings regarding reserves did not lead to any perceptible change of policy on the part of the trustees (paragraph 16). Ms Batmanghelidjh, Chief Executive of Kids Company said that Kids Company's "unpredictable income and overwhelming demand from vulnerable children and families" left the charity with "complex choices" (paragraph 14) and of their ten 2014 priorities building levels of reserves was classed as seventh despite levels of reserves and reliance on ongoing funding promises being their principal risk. Although HMRC gave early warning that the model was not viable the charity continued to be run with no reserves and quite frequently with a deficit on unrestricted funds throughout its existence.

William Shawcross, Chair of the Charity Commission, stated that a responsible approach to reserves is a problem for all charities. He explained: "We advise charities that they should spend their money, and at the same time they must have adequate reserves, so it is quite a hard act for them to follow" (paragraph 19). Ms Michelle Russell, the Director of Investigations, Monitoring and Enforcement at the Charity Commission argued that "if it is a charity that is providing services or has employees or it is working with vulnerable beneficiaries, the trustees have a higher duty of care to make sure that their financial planning and their business model is much more robust and the safeguards are there" (paragraph 20).

Recommendations:
Charities and in particular trustees must not ignore warnings regarding levels of reserves. The six month level of reserves recommended by the auditors of Kids Company is not out of line with levels reported elsewhere in the sector[2]. Kids Company did not set themselves a target or develop a plan to increase their reserves, but based on the evidence given in the report only 'aspired' to have reserves. There is a clear message to trustees and management that reserves targets should be set and justified in the context of the charity's operations. It is a requirement of the FRS 102 and FRSSE SORPs[3] for the trustees to set out in their report their reserves policy, including the target, and their performance against that policy or for the trustees to explain why they do not have a policy. Whilst it may be acceptable for a charity to have lower reserves than its target, for example during periods of controlled growth or other specific activity, there should be a reasonable target set that reflects the needs of the organisation and a long term and achievable plan for financial stability.

The model was not viable and should have been a clear cause for concern

Cash flow

Briefings to Ministers in 2002, 2005, 2007, 2010 and 2015 analysed by the NAO revealed that "officials accepted Kids Company's assertions that it would become insolvent without Government grant funding". The report stated that Kids Company often relied upon emergency government funding to manage its cash flow, with debts of £590,000 being written off by HMRC in 2002, negotiation of payment plans for further taxes and with agreement for upfront funding of government grants (paragraph 23). The report considered that by continuing to fund the charity's cash flow crises, successive governments gave tacit approval to an unsustainable and inadequate business model and eroded any incentive for Kids Company to address its own governance and management failings (paragraph 25).

2 Surveying Trustees Annual Report in the Charity Sector: Balancing Act

3 Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (effective 1 January 2015) paragraph 1.48
Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard for Smaller Entities (the FRSSE) (effective 1 January 2015) paragraph 1.49

Recommendation:
Trustees have a duty to understand the management of the organisation and ensure that it is financially sound and prudent[4]. Early warnings from statutory bodies like HMRC that a model is not viable should be a clear cause for concern to trustees, prompting questions, scrutiny of forecasts and changes in activity.

Reach – how many clients did Kids Company really help?

Trustees were either ignorant of or accepted the inflated figures

The reach figures seem to have been doubted by many of the agencies working with Kids Company, for example, in the report it was explained that "Kids Company referred to the benefit to the whole class of them working with an individual child or young person, so they counted the whole class as 'clients'" (paragraph 31). This meant that when one child was assisted, Kids Company reported their school classmates as having benefitted from the intervention also. Visitors to Kids Company premises reported seeing low numbers of children (paragraph 34). The trustees highlighted that a consulting company validated performance figures, but it is noted in the report that the consultants were only required to validate the data reported against a Government grant, and did not audit the charity's publically reported figures (such as the figure of 36,000 reached and 18,000 reportedly offered intensive support) (paragraph 33). The report considers the lack of evidence for caseloads casts doubt on Kids Company's claims that overwhelming demand rather than financial mismanagement, lay at the root of its financial difficulties (paragraph 35).

Recommendations:
Trustees should understand a charity's operations including the activity 'on the ground'. This allows trustees to challenge and correlate activity and finance.

Trustees should expect that funding bodies, particularly in the public sector, may well be more sceptical about claimed levels of activity and seek more evidence or assurance as part of grant offers and funding claims.

Regulation

The charity did not engage constructively with regulators

Kids Company appeared to operate in a regulatory blind spot with few of its services regulated by Ofsted or the Care Quality Commission (paragraph 37). Kids Company had a policy that "all clinical workers should have qualifications appropriate to their roles and responsibilities, as defined by their professional bodies", however the Chief Executive herself was not a registered member of the UK Council for Psychotherapy despite her active role as psychotherapist and clinical leader (paragraph 38). In addition, as "therapist" is itself not a protected profession, anyone can call themselves a therapist and say that they are offering clinical services (paragraph 37). The Bristol education provision was inspected by Ofsted and a different account of the inspections was given by Ofsted and Kids Company. The report found that the trustees should have been aware of Ofsted's concerns about the Bristol Facilities and taken action as a result. It concluded that either this information was withheld from the trustees or they simply failed to act on it in the ten months between Ofsted's two inspections, which indicated a serious breakdown in proper governance (paragraph 40).

Recommendations:
Having established policies, trustees should check that these are being applied and where necessary enforced effectively.

Trustees should be concerned where regulatory findings suggest that services are unlikely to meet necessary standards and take action where this occurs.

Where there is lack of external, impartial inspection and assessment of outcomes: Trustees should consider how they are satisfied that the outcomes of the charity's actions are achieving its objectives.

4 The Hallmarks of an Effective Charity

No robust evaluations of the outcomes of the Charity's work

Quality of services

None of the trustees had a background in youth services (paragraph 42). The Chair of Trustees stated that trustees were nevertheless confident in the appropriateness of services being delivered because there were inspections and evaluations (paragraph 42). However, the report considered that most of the evaluations were in areas of interest to the charity but not directly related to delivery. This lack of evidence about the charity's outcomes has also been acknowledged by the Government and the Department for Education (DfE) in that monitoring undertaken was mainly related to outputs not outcomes (paragraph 44). There was much anecdotal evidence of positive impact however this was often based on small samples (paragraph 47). The report considered that a robust evaluation of the outcomes of Kids Company's work was lacking and that the charity invested relatively little in highlighting and evaluation the outcomes of its work, despite spending considerable funds on research, gave rise to suspicion in many people (paragraph 47). Without obtaining strong evidence of its impact and outcomes on a wider scale, it was difficult to see how the Trustees satisfied themselves of the appropriateness of the support given to clients, and the value for money offered by the charity's high resource model (paragraph 47).

Recommendation:
Trustees need to make sure they understand the services provided, engage with regulators and where relevant have external assessments of the outcomes from their charitable spending. These elements combined allow trustees to support and defend their actions and plans and demonstrate achievement of their charity's objectives. The FRS 102 SORP states that "The report and accounts taken together should provide a picture of what the charity has done (its outputs) or achieved (its outcomes), or what difference it has made (its impact)"[5]. Trustees should consider what evidence they have and what evidence they need to obtain to support their public reporting.

Trustees' usual critical faculties suspended over the effectiveness of internal controls

Internal controls

Investigations have highlighted lavish spending that the report judged was "inappropriate, unwise and irresponsible, and did not represent a proper use of charitable funds". With a complete lack of experience in youth services amongst trustees, it was impossible for the Board to assess the appropriateness of significant expenditure that the Chief Executive justified on the basis of clinical judgements (paragraph 55). The report stated that it was extraordinary that trustees were content to accept this without more rigorous examination (paragraph 55).

Recommendations:
Whilst trustees will naturally place considerable trust in the chief executive and their experience, they should consider whether they have the necessary experience or comparative information with which to benchmark the actions of their charity, assess the outcomes of those actions and constructively challenge the actions of executives and staff.

Trustees should have an understanding of the charity's internal controls.

Inappropriate handling of safeguarding allegations

Safeguarding

The report concluded that Kids Company's handling of an allegation about a very serious failure of safeguarding was inadequate and irresponsible (paragraph 59). The report judged this was a serious failure on the part of the trustees to ensure the existence and observance of appropriate processes for handling allegations relating to the safeguarding of vulnerable young people (paragraph 59).

Recommendations:
Trustees have a key responsibility to protect and safeguard vulnerable beneficiaries. This includes formal safeguarding, as well as financial prudence in considering the likely impact if, due to a shortfall of funds, the charity has to stop providing its services.

Trustees should check that there are policies and procedures in place to deal with whistleblowing and other allegations.

5 Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (effective 1 January 2015) paragraph 1.12

Insufficient experience of the services provided and long tenure were not conducive to challenge

Board of trustees

The ultimate responsibility for a charity's operations including proper standards of governance resides with the Board. Trustees should make decisions solely in the charity's interests, and they shouldn't allow judgement to be swayed by personal prejudices or dominant personalities. The report considers that trustees suspended their usual critical facilities, particularly over the insistence on the demand-led business model, the Chief Executive's exercise of substantial discretionary powers, the effectiveness of internal controls, and the quality of clinical judgements and safeguarding procedures (paragraph 68). Claims of former directors suggest that the Board did not challenge or question the practices of its Chief Executive and failed to react to claims of mismanagement, unsustainability and inappropriate spending (paragraph 63). The Chair of the Trustees denied that allegations were made and that only one complaint came directly to him (paragraph 63). There was no evidence that the trustees were involved in a decision to turn down a philanthropist's offer of significant financial and human resource (paragraph 66). The report concluded that the length of the Chief Executive and Chair's tenures were not conducive to challenging the Chief Executive herself (paragraph 68) and that the trustees were unwilling or unable to impose sufficient control over the direction and activities of the charity (paragraph 69).

Recommendations:

Trustees should recognise that the Board is legally responsible and has a duty to respond to and investigate allegations in an appropriate manner.

Trustees should ensure that significant decisions, for example, regarding funding, are not taken without informing the Board.

Trustees should consider whether long tenures and familiarity can give rise to misplaced trust and a lack of critical challenge and whether a rolling programme of recruitment of new trustees would help the board to engage with individuals across the organisation, have a breadth of understanding of its activities and a willingness to constructively challenge.

The Charity Commission has been tasked with considering how it can better impress upon trustees the need to ensure that the board includes those with appropriate experience of the areas relevant to the charity's activities and responsible attitudes towards governance. Through self-evaluation or otherwise Trustees should consider how they currently measure up and have regard to any guidance issued by the Charity Commission.

Auditors have a duty to report concerns

Professional services

The report concluded that none of the reviews made by consultants delivered a meaningful assessment of the charity's effectiveness, quality of services, outcomes or value for money. The same challenge was levelled at the audit, although it is not the purpose of a statutory audit to make such an assessment. The report concludes that these reviews and the audit, whilst they may have met the terms of engagement, were inadequate in providing a useful picture of the charity's operations or reassurance to potential donors (paragraph 71). The report does, however, acknowledge that if the repeated warnings from auditors to trustees had been heeded they should have led to a change in reserves policy, contingency planning for insolvency and substantial downsizing many years before the final crisis (paragraph 84).

The report highlights the requirement under s156 of the Charities Act 2011 for auditors and independent examiners to report matters that should be subject to investigation by the Charity Commission. The report judged that the charity's failure to address its precarious funding situation – which ultimately led to the charity folding – the loss of significant charitable funds and the collapse in the support framework for a large number of vulnerable people should have been reported and we expect the Charity Commission and/or FRC to issue more guidance in this area.

Recommendations:

Trustees should assess reviews commissioned by them from professional advisors are appropriately scoped to give the assurance or advice needed, recognising that in many cases such reviews are only part of the information needed to make a decision.

Trustees should check that they have a process for receiving recommendations from the auditor and holding management to account as to their delivery against agreed action plans.

The Charity Commission

The Charity Commission should actively hold charities to account

The Charity Commission only has the power to intervene in the governance of an individual charity if there are specific concerns relating to mismanagement or misconduct (paragraph 100). The report felt that the low level of complaints, despite donors and others expressing concerns as far back as 2002, reflects the Charity Commission's failure to make people aware of this possibility. Complaints would have prompted investigation and could have led to improvements in the charity's governance and operations (paragraph 106). The reports considers that the charity Commission projects too limited a public profile and makes a number of recommendations regarding additional guidance and that the Charity Commission needs to be seen to be actively holding charities to account (paragraph 120). The report develops a number of recommendations for the Charity Commission.

Recommendations:
Trustees need to consider whether they need to give publicity to the complaints process to be developed by the Charity Commission.

Trustees should ensure that they have considered the latest guidance published by the Charity Commission in January 2016 (cc19) Charity reserves: building resilience in developing, implementing, monitoring and reporting on their reserves policy.

Trustees should be alert to guidance issued by the Charity Commission and have systems for capturing and considering any updates to guidance, for example on managing relationships with donors, to ensure that action is taken where necessary.

Government

Government should ensure that funding decisions are based on evidence of outcomes

The report considered the actions of various departments and the interactions between departments (the responsibility for funding Kids Company moved from the DfE to the Cabinet Office) and made a number of recommendations. One of the key concerns raised questioned on what basis successive Governments and other grant-giving bodies, and indeed the charity's trustees, satisfied themselves of the appropriateness of support given to beneficiaries and the value of the charity's high resource model (paragraph 150). The report also made a number of recommendations to Whitehall.

Recommendations:
Trustees should ensure that they understand the expectations of regulators and have policies and procedures in place to manage those requirements.

Trustees should anticipate likely government requests for more information on reach, outcomes and outputs.

Next steps

More resources and how we can help are available in on our website

Trustees should consider their own boards in the light of these findings and assess whether there are identifiable causes for concern in their management, policies or practices.

More resources on Board and audit committee self-assessment and how Deloitte can help you are available on our website www.deloitte.co.uk/charitiesandnotforprofit.

Contacts

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