

How to fulfil your trustee responsibilities

Learning the lessons of Kids Company

Most trustees take their legal responsibilities seriously and are anxious to act appropriately towards their charity. Whilst there is lots of legal guidance, this can be difficult to interpret and it can feel like playing a game of chance, rather like Trustee monopoly - “Go, take a chance, don’t collect £200, don’t go to jail”.

Over recent years the case of the charity Keeping Kids Company has often been cited as an example where the lessons of good governance have been laid bare. This guide uses those lessons, and the observation of good practice in the charity sector, to provide some practical suggestions for trustees so they can be confident they are doing a good job.

Background

In the well-known case of Keeping Kids Company (also known as Kids Company), the Charity Commission and the High Court both had to consider trustee responsibilities, and for many in the charity sector and beyond their conclusions were quite confusing. Although the difficulties that the charity encountered which led to its demise are now around a decade ago, the extensive investigations, legal actions and pouring over the runes lasted many years. Alongside other experiences of charities that have faced challenging times there are general lessons we can take from the Keeping Kids Company's trustees' decisions in relation to trustee financial responsibilities, especially for those that don't have resilient business models. As increasing numbers of charities face financial difficulties, having clarity on legal responsibilities and the practical actions to demonstrate they are being fulfilled is very important.

Trustee Monopoly?

The High Court case involving the directors of the former charity, Keeping Kids Company (KKC), was a landmark in charity law. Its results after the highly publicised insolvency for the charity have significant implications for the state of charity governance post. But it seems that there are confusing messages and apparently contrary advice. It therefore feels that charity trusteeship is like a game of Monopoly. So let's use that as a framework for considering effective charity financial governance.

Key conclusions from the case included that if trustees act reasonably, they are meeting legal responsibilities and not subject to legal disqualifications. You might even say in these circumstances trustees "Don't go to Jail!".

KKC's business model was alleged to be unsustainable, though having a charity which has high risk elements in itself was held to be not a problem. So you may say to trustees "Do take a chance!".

The judgement indicated that financial governance should

reflect the unpaid status of trustees - so for charities this has reinforced the current trusteeship model - so charities should be confident to appoint new trustees and not pay them. So "Pass Go don't collect £200!".

Do "Take a Chance"

The KKC case shows that having a high-risk business model is not a problem per se. So, there is nothing wrong in charities taking a chance, or in business terms to take risks.

But it is important to recognise that being a trustee can be a worrying prospect. It can feel that you have all the responsibility but with limited involvement and day to day insight. Except in small volunteer-led charities where trustees are actively involved, there is a temptation to get reassurance by trustees feeling they must be involved in the details of operations. But good recognised practice and legal judgements confirm that non-executive trustees must preserve the balance of their role between Governance and Management. It is important to recognise though that the trustee / management roles and internal relationships should be dynamic, and at times a greater or lesser involvement is appropriate.

This highlights the critical importance of risk management for good governance. Trustees need confidence in what is going on within the charity to avoid detailed involvement, and this is possible if they feel certain that risks are both being effectively identified by management, and the right risks are being escalated for board understanding and consideration.

In the case of KKC the alleged key risk was its "unsustainable business model". So, what is a sustainable business model? It is arguable this is not one that operates for many years with positive beneficiary impact. A sudden crash and unexpected insolvency, as in the KKC case, is in reality very rare indeed in the sector. Typically, it is more likely that charities wind-up only after long period of decline.

Statistics should that on average less than 1% of



charities wind up in any given year, and most of these are orderly terminations. This suggests the risk of unplanned insolvency is greatly overstated.

So, if there is nothing wrong in principle with charities having a high-risk strategy what mitigations are needed to be acting reasonably? Key assurance checks will include:

- Checking that risks are sufficiently well understood and articulated;
- That the charity has stress-tested their operating models and ensured they are resilient; and
- Confirming in the proposed approach beneficiaries' interests are best served

Going beyond traditional risk management frameworks

At times and for some charities it is appropriate to preserve your commitments to your beneficiary communities more robustly by going beyond traditional risk management frameworks.

At a simple level this could be by regularly checking the effectiveness of your risk management processes. Having a periodic formal review undertaken either internally or externally may be important, especially if facing significant risks.

But charities are now going beyond traditional approaches - a good example is the development of a Board Assurance Framework (BAF). Why is this approach so valuable for some charities? The key reasons are:

- Traditional risk management identifies risk and controls but not how effective those controls are operation;
- A BAF can provide assurance over business functions or key strategies where no major risk has been identified, thereby providing comfort that there are no major concerns within these "business as usual" operations.

A BAF is typically based on identifying a 3 lines of defence model. Simply put, this can be described as:

1st line: Internal controls and assurance within a function or department itself e.g. Finance - key financial controls, HR - workforce plans.

2nd line: Functions that oversee or are internal compliance processes e.g. management controls, senior leadership scrutiny, committee oversight etc.

3rd line: Assurance provided externally or independently e.g. Internal audit, Regulatory inspections, etc.

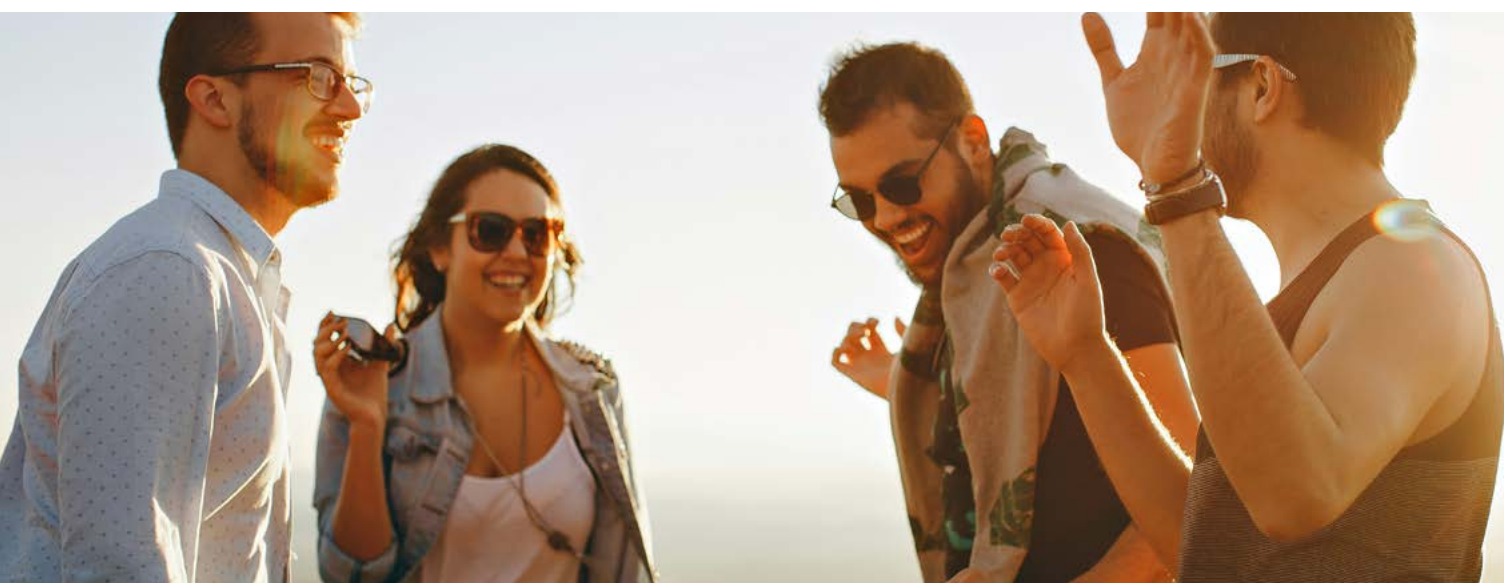
We are assisting charities in establishing a BAF, and certainly it is a helpful approach. But it is important to recognise that it takes time and resources to implement, so for smaller charities it may be worth introducing a partial framework.

The need for charity reserves

It was widely highlighted that KKC had no or very low reserves, though it has plans to address that situation which it was unable to implement. But it would certainly not have been alone - lots of charities are in that position, particularly service delivery charities dependent on property infrastructure for their operations.

The Charity Guidance (called CC19) has existed for over 20 years but has changed greatly over that period. Initially the focus was on charities that had excessive reserves. In the current guidance it states there should be four aspects to all reserves policies which:

- 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

We often see charities that are uncertain how to justify the levels of reserves they would ideally want to hold. Regularly reserve policies state the charity wishes to hold reserves equivalent to 3 months future expenditure as a minimum. The reason for this is sometimes not explained. There is a perception that this would if needed provide time for a charity to organise an orderly winding-up, but an unexpected crash such as income dropping meteorically is very unlikely indeed. Also, as was seen in the KKC case, 3 months reserves will often be insufficient in any case, as winding up can be extremely costly as there are generally unexpected costs involved.

So given unplanned closure is rare, it is appropriate for reserves policies to reflect risks but not for financial turbulence not a fatal crash in finances. In recent years when advising our charity clients, we often guide them through a model which considers reserves through a risk lens and explores use of concepts such as a reserve stress test.

Making your charity safe as houses

It is understandable that trustees get anxious about their financial responsibilities and need further assurance about financial sustainability. Having an appropriate risk and reserve framework is sufficient often, but maybe you are a more complex or service delivery charity with longer term obligations to your beneficiaries. In these situations, you may need to be additionally prudent regarding those commitments.

In the case of KKC there was considerable focus on the demise of the charity entity itself, but in many fora there was not much attention paid to the charity's beneficiaries. Many individuals certainly received services and beneficiary support from other charities and organisations after KKC wound up, but this was more fortuitous than planned.

Some charities will have critical incident plans and business continuity plans - all of which are good and appropriate, but in situations like KKC those further provisions may well still be insufficient. We saw some charities experience this during the COVID pandemic when governance processes became highly stretched.

We now see some charities address this by putting in place organisational resilience assessments. These will vary in each situation but simply this recognises that resilience is dependent on the understanding and awareness of what is really critical for beneficiaries and what will have to be prioritised in an extreme situation.

Effective financial governance

Is there too much "free parking" in charity financial management and governance? By this we mean Trustees and Management not spending enough time and money on financial management governance. Or is consideration of financial matters left to just a few individuals such as the Treasurer or the Finance Committee with other trustees not being sufficiently engaged.

It is fair to observe that it is very rare that trustees are not appropriately motivated and want to support their charity as well as they can. So we can conclude generally trustees and management are meeting their minimum legal responsibilities as now clarified by the KKC case. But is that good enough? Don't our beneficiaries deserve the best possible; and is that being achieved?

Here are some questions you may wish to ask:

- Is there sufficient engagement by individuals throughout the charity? Both trustee and senior leaders
- Is there full integration of board policies and business units or are these set separately and in isolation from the rest of the charity? For example, reserves policies being strongly linked with risk management
- No culture of them and us between the board and management?



- Do you have strong long-term business and financial models adopting where appropriate detailed scenario planning, stress testing ect?

Finance professionals have a unique opportunity to promote best practice as they are one of the charity leaders that has knowledge and insight across the whole organisation. So, they have a responsibility to engage other senior leaders and the board appropriately.

Interacting with your Auditors

It is worth reflecting on your relationship with your external auditors as they should be the charity's critical friend. Ensure your audit is not just an annual visit to check compliance and keep you out of "jail".

If you have spent considerable time and effort in identifying an auditor with specialist knowledge and competency, consider ways they can add further support to your charity.

But a word of warning, if they have this expertise and you don't heed their advice, ignore it at your peril!

Trustee onboarding

We have noted that trustees almost always are highly motivated and committed. That was certainly the case with KKC yet there still appear to be areas where they could have achieved better ultimate results even though they met legal duties.

Typically, trustees are appointed due to having specific skills and experience that is seen as relevant. But often they are given little induction and training on appointment or subsequently. New trustees seldom have buddies or mentors. In other employment situations this would be seen as a significant HR weakness.

Many charities state they follow the Charity Governance Code. The foundation principle is that trustees have a strong understanding of their role and legal responsibilities, particular in the context of their own charity.

So, do your trustees start acting immediately or only once they have a good awareness of what they need to know through induction or training?

Car drivers that are caught speeding are offered the chance to do a Drivers Awareness Course. Most state they emerge from the course as better drivers.

You may therefore want to consider if your charity should introduce a Trustee Awareness Course for new trustees.

For further information on any of these topics, speak to members of the MHA Not for Profit team.

How we can help

If you would like to discuss any matter arising from this example policy please contact MHA on info@mha-uk.com or your usual MHA contact.

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