

# **Inquiry Report**

**Odyssey (Tendercare) Limited**

Registered Charity Number 1104244



# A statement of the results of an inquiry into Odyssey (Tendercare) Limited (registered charity number 1104244).

Published on 8 December 2015.

## The charity

Odyssey (Tendercare) Limited ('the charity') was incorporated as a private company limited by guarantee on 5 September 2000 under company number 4064799. The charity was registered as a charity on 9 June 2004. It is governed by memorandum and articles of association, as amended by written resolution dated 24 February 2004.

Its objects are:

'to relieve the sick and in particular individuals suffering from life threatening issues by the provision of holistic, natural and complimentary therapies and nutritional education and to support their carers and families by the provision of equipment and services not provided from statutory funds.'

In practice, the charity provided therapies such as reiki, aromatherapy and reflexology to people with a cancer diagnosis and their carers from Barton-upon-Humber in North Lincolnshire.

More details about the charity are available on the [register of charities](#) ('the register').

## Trustees

Since its incorporation and subsequent registration with the Charity Commission ('the commission'), the charity has had a number of different trustees/directors. At times the individuals listed as directors with Companies House were not the same as those listed as trustees with the commission.

However, throughout the commission's engagement with the charity 3 individuals played a central role as trustees of the charity, Thomas Hazeldine ('trustee A'), Richard Morgan ('trustee B') and Dasia Morgan ('trustee C').

## Source of concern

In May 2008 the charity's then auditors wrote to the commission 'reporting a matter of material significance'. The auditors reported that the charity had loaned approximately £3 million to its subsidiary company. The auditors advised that the subsidiary company was 100% wholly owned by the charity and that the shares in the subsidiary company were transferred whilst it was technically insolvent. The auditors reported that the money loaned from the charity had allowed the subsidiary company to develop a hotel but due to its financial instability this money had subsequently been written off as unlikely to be repaid and, therefore, this set of events represented a significant loss of charitable assets.

## Background

In the 1990's the charity's founding trustees - trustee A, trustee B and trustee C - set up the charity and purchased a site on the Humber Estuary which consisted of a 6 bedroom guest house and 2 cottages. The 2 cottages were converted into a therapy centre, whilst the guest house was converted and a hotel business was established trading under the name Reeds Hotel. Over the years additional land was acquired and the hotel was extended.

A company called Odyssey Holdings Limited owned the land and building and a company called Reeds Hotel ran the business of the hotel. The directors of Odyssey Holdings Limited were trustee A and trustee B. The directors of Reeds Hotel Limited were trustee A and his daughter<sup>1</sup>. The charity was originally established as a trust by the name of the Odyssey Foundation. The assets of the trust were transferred to the charity upon its incorporation.

## Investigation

On 28 May 2008, after assessing the issues against its then risk framework<sup>2</sup>, the commission opened an investigation, which at the time was called a regulatory compliance case ('RCC') into the charity. It was subsequently escalated to a statutory inquiry ('the inquiry') under the then section 8 of the Charities Act 1993 (now section 46 of the Charities Act 2011) on 11 August 2009.

The commission initially received varying levels of cooperation from the trustees; information and documentation regarding the detail of a loan of c£3 million from the charity to its subsidiary company and the wider management of the charity was not forthcoming. The commission wrote to the trustees on numerous occasions by letter and email. When the responses received did not answer the questions asked, the commission issued formal orders on the trustees compelling them to answer the commission's queries.

Following further rounds of correspondence, 2 meetings took place between the commission and the charity, the first on 28 January 2009 and then again on 24 April 2009.

At the meeting on 24 April 2009 trustee A and trustee B were reminded that they were under an obligation to tell the truth to the commission and that they were expected to answer honestly the commission's questions.

In July 2009, as part of its routine investigative enquiries, the commission discovered that in March 2009 HMRC had presented a petition for insolvency against the charity's subsidiary company Reeds Hotel Limited and on 17 April 2009 it had gone into administration. Given that the meeting on 24 April 2009 had discussed this company specifically, and that the commission had sought information on its status, the commission was concerned about the trustees' lack of disclosure.

The commission learnt, as part of the same enquiries, trustee A, in his personal capacity, had formed a new company, and arranged with the administrator that the activities of the subsidiary company would be sold to the new company under a 'pre-pack administration' process. This new company was now outside the control of the charity but was said to be a 'social enterprise' which would donate its profits to the charity to apply towards its objects. This arrangement was not formalised by way of any formal agreement or the new companies' governing document.

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1 At this time trustee A's daughter was also a trustee of the charity, she was also trustee C's daughter. She ceased to be a trustee in December 2009.

2 Called the 'Risk and proportionality framework for compliance work'.

## 2009 inquiry

Given these developments and in particular the lack of full and frank disclosure by the trustees, on 11 August 2009, the case was escalated to a statutory inquiry. The scope of the inquiry was to examine a number of issues including:

- (1) The administration, governance and management of the charity by the trustees, in particular:
  - (a) the legal structures created by the trustees to manage the charity
  - (b) financial management and decision-making
- (2) Whether or not the trustees had complied with and fulfilled their duties and responsibilities as trustees.

The inquiry closed on 8 December 2015 with the publication of this report.

The inquiry involved a number of complex issues, including scrutiny of the relationships and financial transactions between the charity, its subsidiary companies and connected private companies. Progress was hampered by the lack of full co-operation from some of the trustees and their inability to answer what in the commission's view were straight-forward questions. This significantly lengthened the processes to gather and verify evidence. In addition, the commission had to liaise with the liquidator(s) and other regulators.

The commission initially took steps to work with the trustees to put the charity back on a secure footing and enable the charity group to move forward as a going concern. As the nature and extent of the issues connected with the group structure and relationships with the various companies became clearer, including doubts about the financial viability of the subsidiaries and companies, the commission changed its approach. However it did not have the powers to take the remedial action it wanted to take. Some of the trustees resigned, it was highly unlikely new trustees would be found and there were insufficient funds in the charity to fund an Interim Manager. In the latter stages of the inquiry, the commission changed its strategy and sought to exercise a power to petition for the charity to be wound up<sup>3</sup>. There are currently very limited circumstances when the commission can put pressure on others to wind up a charity even on the basis that it does not have enough funds to meet its debts. The commission's view was that public trust and confidence was best served by this. The commission was in the process of making a referral to the Attorney General for consent to petition for the charity to be wound up, when the charity was placed into liquidation.

During the period the inquiry has been open the commission's broader **regulatory approach** has changed. It now takes more decisive action and is bolder in using statutory powers where there is reason to doubt the veracity of information provided, or where trustees are slow or unwilling to respond to concerns. If these issues arose now, they would be dealt with in a different way.

Details of the commission's findings and conclusions are set out in the following sections.

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<sup>3</sup> Under section 113 of the Charities Act 2011, the commission has the power to petition for a charity to be wound up. To exercise this power the commission must obtain the consent of the Attorney General.

## Findings

### Issue (1) the administration, governance and management of the charity by the trustees

#### (a) The legal structures created by the trustees to manage the charity and management of the charity's investment

The inquiry established that in 2005/2006 the shares in Reeds Hotel Limited were gifted to Odyssey Holdings Limited and the shares in Odysseys Holdings Limited were transferred to the charity by way of gift from trustee B. As a result Odyssey Holding Limited ('the first subsidiary') and Reeds Hotel Limited ('the second subsidiary') became subsidiary companies of the charity. The commission was informed by the trustees, during the course of the inquiry, that this structure was designed with the aim that the hotel business would generate enough surpluses to pass its profits to its shareholder, the first subsidiary, which, in turn would pass its profits (once the property's liabilities had been paid) to its shareholder, the charity, to apply in furtherance of the charity's objects.

Charities sometimes undertake trading activities through wholly owned trading subsidiaries and Gift Aid some or all of the profits of that trade to the parent charity to fund the charity. In this case, the inquiry found that the financial viability of the group structure and individual companies was not sound. The inquiry established that, the charity and first subsidiary were, since as early as 2005, in a precarious financial position. The inquiry established that both the first subsidiary and second subsidiary had incurred substantial debts through bank overdrafts when developing the hotel site and the associated hotel business. The income streams for both subsidiaries were dependent on the success of the hotel business. Due to the significant debts incurred in the development of the hotel site, the hotel business never appeared to be profitable. Both of the charity's subsidiaries were in financial difficulty and there was a risk that the charity would end up propping up the subsidiaries, rather than the subsidiaries underpinning the financial viability of the charity.

Concerns about the nature and financial viability of the structure were confirmed when in April 2009 the second subsidiary was placed into liquidation and subsequently sold to the new company ('the social enterprise') which was also controlled by trustee A. The trustees advised the inquiry that the social enterprise was established with the aim that any profits would be passed to the charity to further its charitable purposes. However, the inquiry found no evidence that where profits were generated by this business they were routinely passed to the charity<sup>4</sup>.

When the 2012 accounts of the charity and the first subsidiary were examined by the inquiry in 2013, it was the commission's opinion that both entities failed the tests of solvency<sup>5</sup>. Further assessments conducted by the inquiry indicated that this had been the case intermittently since at least 2008.

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4 On 21 December 2012 the Social Enterprise (Reeds Country Hotel Limited) went into voluntary liquidation having sold its assets to a new company called Reeds Hotel Ltd. Trustee A was the sole director of this company. From November 2012 the hotel business was run by Reeds Hotel Ltd. In January 2014 Reeds Hotel Ltd went in to voluntary liquidation.

5 There are 2 tests of potential insolvency for a business: the cash flow or short-term liquidity test and the balance sheet test. The cash flow insolvency test refers to section 123 (1) of the Insolvency Act 1986 which says that a company is deemed unable to pay its debts if a creditor leaves a written demand requiring the company to pay the sum due and the debt remains unpaid for 3 weeks. The balance sheet insolvency test refers to section 123 (2) of the Insolvency Act 1986 which provides that a company will be deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into accounts its contingent and prospective liabilities. These are standard tests widely used in the insolvency industry.

Trustees must be satisfied that the particular company they are investing in is financially viable based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information and must take appropriate advice on the investment and the financial viability of the subsidiary trading company. Investing in a company which is not economically viable, and has no real prospect of becoming so, would not be a prudent investment. This would be the case where the investment is to be used to pay the debts of an insolvent company before it goes into liquidation, solely to prevent it having to be treated as an insolvent company. The trustees should have exercised greater care and skill when making the decisions to (i) accept the shares in the first subsidiary and (ii) invest in the subsidiaries. The charity's relationships with the subsidiary companies and the risks to the charity and its funds should have been regularly reviewed. It was not evident to the inquiry that they did so.

### **(b) Decision-making about financial management**

Charity trustees are charged with the responsibility of managing their charity and in doing so they exercise discretion. When exercising their discretion charity trustees must:

- act within their powers
- act in good faith and only in the interests of the charity
- make sure they are sufficiently informed
- take account of all relevant factors
- ignore any irrelevant factors
- manage conflicts of interest
- ensure they have taken and considered professional or other specialist advice or read any relevant guidance where they ought to have done so
- make decisions that are within the range of decisions that a reasonable trustee body could make

The inquiry found that decisions made by the trustees with regard the arrangements between the charity and its subsidiaries failed to comply with these principles.

## **Writing off debt**

In 2003 (prior to the charity's registration with the commission) trustee B made donations of over £3 million from his own assets to the charity which was used to clear the overdrafts that had been built up in the subsidiary companies. Later, in 2005 (after the charity's registration with the commission), the charity claimed Gift Aid on some payments asserting that because of the structure of the group they were charitable donations. The inquiry was informed by the trustees that they took the decision to retrospectively regard the payment as a loan from the charity to its subsidiary companies. The trustees supplied the inquiry with a copy the retrospective legal advice obtained regarding the legality the decision. The trustees also advised that then, following accountancy advice; the loan was subsequently written off in the charity's accounts on the basis that the subsidiaries could not meet their liabilities. Despite numerous requests the trustees failed to provide the inquiry with a copy of the accountancy advice supporting this decision. The inquiry corresponded with and met the charity's then accountant who advised the commission that providing against the loan was the only way to accurately reflect a true and fair view in the charity's accounts.

Charity trustees must be able to justify financial support for a trading subsidiary as an appropriate investment of the charity's resources. The interests of the charity must be paramount. The trustees were unable to demonstrate that they had made the decision to lend the money to the charity's subsidiary properly and the fact that it was written off demonstrates that the charity has lost the money as a direct result of improper decision making.

## Making loans

Trustees of all charities need access to accurate and up-to-date financial information to enable them to make proper decisions. All decisions by the trustees concerning their charity should normally be taken collectively and significant decisions and action points noted in writing. The financial information provided at trustee meetings ought to include details of the charity's financial position and performance including:

- the latest management accounts
- a comparison of budget to actual figures
- an explanation for variances between forecasts and what actually happened
- details of cash flow and closing bank balances

The inquiry found no evidence that the trustees received this financial information. The inquiry found that the management of the charity and the subsidiaries' finances was poor and there was insufficient consideration of the financial situation. For example, despite its continued engagement with the trustees regarding its regulatory concerns, including the trustees' failure to appropriately manage its finances and account for their decision making, in January 2013 £59,000 was transferred from the charity to the first subsidiary. When the inquiry asked the trustees about the transaction trustee A described the payment as a 'loan'. The inquiry's scrutiny of the minutes of trustee meetings found no evidence to show the 'loan' was discussed or agreed by the trustees collectively. Two of the trustees<sup>6</sup> confirmed to the inquiry that they were unaware that the payment had been made to the first subsidiary.

The inquiry was not satisfied that the decision to lend £59,000 to the first subsidiary was a prudent one nor shown to be in best interests of the charity in compliance with the trustees' fiduciary duties for the following reasons:

- the charity's accounts prior to the transaction showed it to be balance sheet insolvent, with creditors falling due within one year of £38,572 and total funds of £24,757
- the effect of the transaction was to leave the charity with only £413.87 in its bank account
- there was no evidence that the trustees took either legal or financial advice on the terms of the loan or how to ensure that the charity's interest was protected
- there was no loan agreement to formalise the arrangement or provide for the payment of interest or demonstrate a viable or objective investment strategy for the charity
- the first subsidiary was also balance sheet insolvent and was unlikely to be able to repay the loan

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<sup>6</sup> Helen Challenger and Celia Summerscales - Helen Challenger and Celia Summerscales were appointed as trustees on 27 October 2011. They resigned from their positions on 4 February 2013. Ms Challenger and Ms Summerscales were never appointed as directors of the charity with Companies House.

- the first subsidiary had failed over an extended period to covenant any monies to the charity and the inquiry was not provided with evidence which indicated that it would be able to do so in the future
- the monies could have been used to fund the charity's charitable activities for some time

The limited information the trustees provided stated that the loan was made in order to progress the first subsidiary's development plans. The trustees were unable to provide evidence of those development plans or demonstrate that they had considered and assessed how realistic it was to expect the first subsidiary to be able to repay the loan or provide the charity with any income. As referenced page 4, the first subsidiary had been in a precarious financial position since 2005. The inquiry was not convinced that a body of trustees acting reasonably and having, considered all the relevant factors would have decided that it was in the best interests of the charity to lend £59,000 to the first subsidiary.

## Challenging tax tribunal

The absence of collective and informed decision making on the part of the trustees was further evidenced in the decision to challenge a HMRC tax assessment.

In July 2007 HMRC issued an assessment to recover a sum of monies which had wrongly been claimed by the charity and mistakenly paid out under a 'pay now – check later' working practice. The tribunal determined that funds paid by trustee B to the first subsidiary and the second subsidiary were not qualifying donations to a qualifying charity which was the basis upon which the Gift Aid was initially paid. The commission notes that the tribunal judgement stated that its "findings implied no wrong-doing on the part of [trustee A] and [trustee B]. The purported claim for Gift Aid arose from a misunderstanding of the legal requirements governing such claims".

During a meeting with the trustees in November 2012 the inquiry team established that not all the trustees were aware of the charity's application to the tribunal or HMRC's decision. Furthermore, during the same meeting it became apparent that trustee A and trustee B had made a decision to lodge and pursue an appeal against the tribunal decision.

One of the trustees later stated, in an email to the inquiry on 4 February 2013:

*"There are no minutes available due to the short notice given i.e. 48 hours through Inland Revenue Solicitors. The date the decision was made was 25<sup>th</sup> October 2012 and due to time constraints, no legal advice was sought. It was I who made the application with an agreement from [a trustee]."*

Permission to appeal to the Upper Tribunal was refused on 9 May 2013 and a final tax demand issued to the charity shortly afterwards. The charity was placed into company voluntary liquidation on 13 June 2014 as a direct result of its failure to pay the tax demand. Further details are referred to on page 10.

The inquiry found that not all the trustees were updated of key issues and important developments about charity business trustees should have known about. Two of the trustees were content to operate the charity without reference to their fellow trustees.



## Conflicts of interest

Trustees have a legal duty to act only in the best interests of their charity. A conflict of interest is any situation in which a trustee's personal interests or loyalties could, or could be seen to prevent the trustee from making a decision only in the best interests of the charity.

The inquiry found that the trustees had no understanding of what a conflict of interest is or its impact on decision making. Due to the commonality of individuals acting as the trustees of the charity, directors of the subsidiaries and director of the social enterprise there were clear and inherent conflicts of interest in all decisions taken relating to financial transactions between the various entities and the charity's oversight of its wholly owned subsidiary companies. The trustees failed to demonstrate to the inquiry that there was adequate separation of responsibilities between the entities or that there were sufficient independent trustees appointed to ensure conflicts of interests were properly managed. The failure of the trustees to identify, remove or manage the inherent conflicts amounted to misconduct and mismanagement in the administration of the charity.

When, in October 2011, 2 suitably independent trustees were appointed to the charity it was possible for valid decisions to be made by the trustee body regarding the charity's management of the first subsidiary and consequently its relationship with the social enterprise. However, the independent trustees were not included in all the decision making arrangements regarding the management and administration of the charity and as a result the conflicts of interest remained unmanaged.

The 2 independent trustees resigned on 4 February 2013.

## Management of the first subsidiary

During the inquiry the trustees provided conflicting and confusing information about the finances of the charity and the subsidiaries. Throughout the investigation responses to what ought to have been straight forward questions about the charity's income and expenditure were not forthcoming. The trustees had limited explanations to justify the expenditure of money flowing through bank accounts connected to the charity and its subsidiary companies. For example, during a meeting in November 2012, the trustees informed the inquiry that all rental payments due from the social enterprise to the first subsidiary were up to date.

The inquiry established that the social enterprise was not up to date with its rental payments. An examination of the first subsidiary's bank statements for the period 1 January 2012 to February 2013 identified no regular payments were made by the social enterprise to the first subsidiary. This suggests that in effect the first subsidiary and in turn the charity were subsidising the finances of the social enterprise. The first subsidiary failed to take any action. One option would have been for the first subsidiary to evict the social enterprise for failure to pay its rent and find another tenant. The conflicts of interest meant that this was never properly considered.

## **Issue (2) whether or not the trustees had complied with and fulfilled their duties and responsibilities as trustees**

Where trustees seek to enter into trading arrangements or any other decision, such as those which arose in this charity, they must act in accordance with their duty to exercise reasonable care, skill and diligence and ensure:

- the arrangements are lawful
- they have the power to enter into the arrangements in question
- they are neither conflicted nor have the potential to benefit personally from any arrangement
- they take and consider appropriate independent specialist advice about obtaining fiscal relief or minimising tax in the context of their responsibilities, such advice being independent of both the charity and the promoter of any proposed arrangements
- a record is kept of their decision-making including any tax law, tribunal decision or professional advice upon which they are relying
- by entering into the arrangement, that they do not expose any of the charity's property to undue risk
- that the proposed transactions will not damage the reputation of the charity and that they have considered how the character of the arrangements fits with the aims of the charity and the ethos of its donors and beneficiaries
- overall, that the arrangements are in the best interests of the charity

The inquiry was not satisfied that the trustees showed they had discharged their duty of care. Furthermore, as set out on page 8, the trustees breached their duty to avoid conflicts of interest.

During the inquiry trustee A, trustee B and trustee C repeatedly failed to comply with the commission's orders. The loan of £59,000 to the first subsidiary in January 2013 was made in breach of the orders made by the commission in 2010. On 15 December 2010 the commission made orders under section 18 of the 1993 Act (now section 76 of the 2011 Act) ('the 2010 orders') restricting the transactions into which the trustees could enter. The 2010 orders were personally issued to each of the then trustees, trustee A, trustee B and trustee C.

Contrary to the 2010 orders, written permission to enter into the transaction was not sought or obtained. On 24 June 2013, the commission issued an order under section 84 of the 2011 Act requiring the recovery of the loan made in breach of the commission's order and directing the then trustees - trustee A and trustee B - to provide a report detailing the action taken to effect this within 28 days. No report was received and the loan was not repaid.

The failure of trustee A and trustee B to comply with commission orders is clear evidence of misconduct and/or mismanagement in the administration of the charity.

## Liquidation

The charity was placed into company voluntary liquidation in June 2014 and a liquidator appointed. The role of the liquidator includes investigating the financial affairs of the company and maximising the return to creditors. The role of determining whether any improper activity has occurred leading to the closure of the company is undertaken by the Secretary of State for Business Innovation and Skills ('BIS') following a referral by the liquidator. The liquidator is responsible for recovering any funds due to the charity because of the trustees' breach of duty.

The commission has continued to monitor matters during liquidation. The commission established that on 23 December 2014 an annual return for the first subsidiary was submitted to Companies House listing trustee B as the sole shareholder<sup>7</sup>. On 24 March 2015 an annual return for the first subsidiary was submitted to Companies House listing trustee B and trustee A as holding shares in the first subsidiary. On 25 March 2015 the commission contacted the liquidator who confirmed that he had no knowledge of the transfer of the charity's shares in the first subsidiary to trustee B and subsequently trustee A. This was verified and confirmed in an email dated 15 April 2015.

Following the charity's liquidation, trustee B did not have the power to act in dealing with the assets of the charity. It is the commission's view that in transferring shares belonging to the charity to himself and subsequently to trustee A, trustee B breached the trustee duty of care and the duty to protect the charity's assets. Trustee B failed to act in the best interests of the charity and in the commission's view this amounted to misconduct and mismanagement in the administration of the charity. As a charitable company it is the commission's view that trustee B also breached company director duties<sup>8</sup>, furthermore the transaction in itself was self-dealing. The liquidator agreed that the transfer was a breach of trustee B's duties but due the fact that the shares were at the considered to be nil value he would not be taking action to reverse the transaction.

Furthermore, it is the commission's view that in disposing of shares belonging to the charity trustees B poses an ongoing risk to charitable property.

At the time the charity's shares in the first subsidiary were transferred to trustee B and subsequently to trustee A they were considered by the liquidator to be of nil value<sup>9</sup>. However, the nature of shares is that their value can change and the commission has therefore concluded that despite the fact that the transfer did not represent any monetary loss to the charity at the time the value of the shares could change and trustee A and trustee B could benefit privately from the transfer in the future. As a result and using this as evidence of misconduct and mismanagement in the administration of the charity, the commission took action to remove trustee B as a charity trustee. This action was effective on 1 June 2015.

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7 At this time trustee B was the sole trustee of the charity, trustee A was disqualified from acting as a company director for a period of 2 and half years in February 2015 and trustee C had resigned on 8 February 2013.

8 Companies Act 2006:

Section 171 - duty to act within your powers

Section 172 - duty to promote the success of the company (in this case the charity)

Section 174 - duty to exercise reasonable care skill and diligence

Section 175 - duty to avoid a conflict of interest

Section 177 - duty to declare an interest in a proposed transaction

9 On 15 April 2015 the liquidator confirmed to the commission that in his view the shares currently have zero value as the net asset position of Odyssey Holdings Limited is significantly negative ie probably about £1.8 million.

The liquidation process remains ongoing; the commission is continuing to liaise with the liquidator and is monitoring progress to ensure that any residual funds are applied in accordance with the charity's governing document. The commission did consider waiting until the outcome of the liquidation process before closing its investigation and publishing this report, however, as it is currently unknown how long this will take and there is no further immediate action for the commission to take the inquiry has been closed and report published.

A supplementary report will be published with relevant updates when the liquidation process is completed and the outcome known.

## Conclusions

Whilst the charity may have provided valued services to people with a cancer diagnosis and their carers the commission concluded that the limited charitable activity was secondary to the primary activity of running and maintaining the hotel business. The charity's income, including a donation of c£3 million, was being used to fund the hotel business with little to no return to the charity. The structure chosen by the founding trustees to fund and manage the charity was not a viable business model.

Initially the commission's strategy was to work to regularise matters and put the charity back on a proper footing. In 2011 new independent trustees were appointed, but they resigned in 2013, along with trustee C. The commission could not appoint an Interim Manager as there were insufficient funds to appoint one.

As the inquiry continued, further acts of misconduct and breaches of fiduciary duty materialised. The trustees failed to properly manage the charity and failed to take decisions that were in the best interests of the charity. Proper records were not maintained and conflicts of interest were not managed. The commission concluded that the trustees failed to avoid putting themselves in a position where their duty to act only in the best interests of the charity could conflict with any personal interest they may have and as such were in breach of the legal duty to avoid conflicts of interest and promote the success of the charity.

In continuing to operate both the charity and its subsidiary company, whilst both entities were failing the tests of potential insolvency, the trustees acted in breach of their duty of care to the charity.

Once the extent of the mismanagement and misconduct was identified trustee A and trustee B were the only remaining trustees, and the grounds for suspension and removal were so similar that it would not have been possible to lawfully distinguish between the 2 for regulatory action and remove one without the other, which would leave the charity with no trustees.

The commission's steps to petition for the winding up of the charity on the basis of insolvency were overtaken by events resulting in the liquidation of the charity. However, due to subsequent events and further acts of misconduct and mismanagement in the administration of the charity and the risk to charitable property by the transfer of the shares in the first subsidiary the commission concluded that it was necessary and desirable to act to protect charitable property and remove trustee B as a charity trustee, on 1 June 2015. Trustee A was also disqualified for other reasons from being a company director therefore disqualified from acting as a trustee of other charities.

## Regulatory action taken

The inquiry team undertook a number of regulatory actions including:

- orders made under the then section 9 of the Charities Act 1993 ('the 1993 Act') and now section 52 of the Act to obtain copies of the charity and subsidiary companies' bank statements
- meetings were held with the trustees on 2 occasions as part of the RCC and the inquiry met with the trustees again in August 2009, March 2011 and November 2012
- escalation to statutory inquiry on 11 August 2009 under the then section 8 of the 1993 Act (now section 46 of the Act)
- the September 2009 orders under section 18 of the 1993 Act (now section 76 of the Act) restricting the transactions into which trustee B and trustee C (being the only trustees at that time) could enter; under the terms of the orders the trustees were not, without the prior written permission of the commission, to enter into the following types of transaction:
  - the re-mortgage of any assets belonging to the charity or the first subsidiary
  - the obtaining of any loans secured against any assets belonging to the charity or the first subsidiary
  - the obtaining of any additional or new loan or credit facility on behalf of the charity or first subsidiary

In December 2010 a similar order was issued to trustee A upon his reappointment. The trustees did not comply with the orders.

- the June 2013 order under section 84 of the Act requiring the recovery of the £59,000 loan made in January 2013 and directing trustee A and trustee B to provide a report detailing the action taken to affect this within 28 days; the trustees did not comply with the order

The suspension and removal of trustee A, trustee B and trustee C was considered during the course of the inquiry. However, once the extent of the mismanagement and misconduct was identified trustee A and trustee B were the only remaining trustees<sup>10</sup>. To suspend and remove them at that point would have left the charity without any trustees. Had the charity had more than 2 trustees the commission would have sought the suspension and removal of trustee A and trustee B. At the time the grounds for their removal were so similar that it would not have been possible to lawfully distinguish between the 2 for regulatory action and remove one without the other.

In addition, on 12 January 2015 trustee A was disqualified from acting as a company director for a period of 2 and half years. Consequently trustee A is also disqualified from acting as a charity trustee and in accordance with the charity's governing document he automatically vacated his office as trustee upon disqualification.

However, as set out on page 10 on 1 June 2015 trustee B was removed as the inquiry determined that the disposal of the charity's assets by trustee B was clear evidence of misconduct and mismanagement in the administration of the charity and despite the appointment of the liquidator posed an ongoing risk to charitable property<sup>11</sup>.

As set out on page 10, as a charitable company it is the commission's view that trustee B also breached company director duties; furthermore the transaction in its self was self-dealing, as such on 4 June 2015 the commission made a disclosure to the Insolvency Service informing them the trustee B's actions.

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<sup>10</sup> Trustee C resigned on 8 February 2013 but her resignation was never recorded with Companies House.

<sup>11</sup> Unlike before, leaving the charity without any trustees was not legally problematic as the liquidator is in place to hand title to remaining assets and manage the charity's affairs.

The commission considered restitution proceedings against trustee A, trustee B and trustee C. The role of the liquidator includes a responsibility for recovery of any funds lost as a result of the trustees' breaches of their duties. As such the commission decided, in line with its policy on restitution and the recovery of charitable funds misappropriated or lost to charity in breach of trust, the liquidator was best placed in this case to do so. The commission was also mindful that given the tax debt of the charity it was doubtful that any funds recovered by restitution proceedings would be applied for charitable purposes. Further information regarding the **commission's approach to restitution** can be found on GOV.UK.

As stated at the start of this report, during the period the inquiry has been open the commission's broader **regulatory approach** has changed. It now takes more decisive action earlier and is bold in using statutory powers where there is reason to doubt the veracity of information provided, or where trustees are slow or unwilling to respond to concerns. If these issues arose now, they would be dealt with in a different way.

The commission contacted the former trustees referred to in the report on 1 September 2015 and informed them of its findings. In line with commission procedure they were given the opportunity to comment on the factual accuracy of the report prior to its publication. As of 30 November 2015 the commission had not received any comments regarding the factual accuracy of the report. On 30 November 2015 the finalised report was issued to the former trustees and they were advised that it would be published on 2 December 2015. Trustee A contacted the commission the same day and disputed that he had received the commission's correspondence of 1 September 2015, requesting additional time to comment on factual accuracy. The commission received an email from trustee A on 3 September 2015 referring to the 1 September 2015 letter and on or around 3 September 2015, a member of the commission spoke with trustee A and trustee B regarding the report. Despite this trustee A still maintained that he had not seen a copy of the report prior to 30 November 2015 and as such wanted the opportunity to review it. Trustee A was granted 24 hours to submit any comments as to the factual accuracy of the report. As such publication was delayed.

## Issues for the wider sector

Trustees are responsible for the overall management and administration of their charity.

It is vital that all trustees understand and comply with their legal duties, which are explained in the commission's publication **The essential trustee: what you need to know, what you need to do (CC3)**. These include ensuring that a charity is carrying out its purposes for the public benefit, acting only in the charity's best interests, and managing its charity's resources responsibly.

Acting in the charity's best interests means dealing appropriately with conflicts of interest. It also means making balanced and adequately informed decisions, as explained in the commission's publication **It's your decision: charity trustees and decision making (CC27)**.

Managing a charity's resources responsibly includes ensuring that the charity's assets are only used to support or carry out its purposes, avoiding exposing the charity's property to undue risk, and taking special care when investing or borrowing.

Trustees of charities with one or more trading subsidiaries need to be aware of their responsibilities. In particular they need to remember, in all decisions made in regard to a trading subsidiary, that the interests of the charity are paramount. The interests of a trading subsidiary, its directors, creditors or employees, must all be secondary to those of the charity.

This is because the purpose of using a trading subsidiary is to benefit the charity in some way, for example to protect the charity's assets from the risks of trading, or to increase the level of financial return to the charity by saving tax. If the charity's assets are employed or put at risk for the benefit of the subsidiary, or its directors, creditors or employees then that purpose is frustrated. In such cases, the trustees of the charity may be personally liable for any loss of, or decline in value of, the charity's assets.

Further information on charities and trading can be found in the commission's publication **Trustees trading and tax: how charities may lawfully trade (CC35)**.

When assessing whether an investment in a subsidiary trading company would be appropriate for the charity trustees must:

- consider whether it is in the charity's interests to make an investment in a subsidiary trading company after making a fair comparison of this form of investment with other forms of investment available - this should involve an objective assessment of the company's business prospects (the suitability of the investment type or class)
- be satisfied that the particular company is financially viable based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information (the suitability of the investment within that asset type or class)
- take appropriate advice on the investment and the financial viability of the subsidiary trading company; what is 'appropriate' will depend on the circumstances - the cost of taking the advice is a relevant factor, and should be proportionate to the size of the proposed investment (considering and taking advice if appropriate)
- decide the nature of the investment in the subsidiary trading company, taking professional advice as needed (the trustees' duty of care)
- consider from time to time whether the investment in the subsidiary trading company should be retained (the review and diversification of investments)

Trustees should also:

- take account of the length of time over which funds may be tied up in an investment in a subsidiary trading company, since funds invested in this way may not be easily realised if they are needed in the short to medium term
- consider, and take suitable advice on, the possibility of obtaining funding from another source as an alternative to funding by the charity

Investing in a company which is not economically viable, and has no real prospect of becoming so, would not satisfy the criteria listed. This would be the case where the investment is to be used to pay the debts of an insolvent company before it goes into liquidation, solely to prevent it having to be treated as an insolvent company.

Sometimes a subsidiary trading company can be set up to further both the charity's aims and to generate a financial return. It is important that trustees are able to justify the investment either on the basis of the financial return or the extent to which it furthers its aims.

Further information regarding charities and investments can be found in the commission's publication **Charities and investment matters: a guide for charity trustees (CC14)**.

We expect individual trustees and trustee bodies to be able to identify any conflicts of interest at an early stage. The law says that each individual trustee must avoid putting themselves in a position where their duty to act only in the best interests of the charity could conflict with any personal interest they may have. In practice this means that:

- individual trustees who fail to identify and declare any conflicts of interest will fail to comply with their personal legal responsibility to avoid conflicts of interest and act only in the best interests of the charity
- the trustee body must ensure that any conflicts of interest do not prevent them from making a decision only in the best interests of the charity

Further information regarding conflicts of interest can be found in the commission's publication **Conflicts of interest: a guide for charity trustees (CC29)**.