CHARITY COMMISSION
FOR ENGLAND AND WALES

Group Case Report

Charities at risk of financial distress

Why the Charity Commission got involved

The monitoring team undertook proactive analysis of and compliance visits to a group of charities identified as having signs they may be at risk of financial distress, including potential insolvency. The aim was to seek assurances that trustees understood their duty to protect charity assets; had adequate measures and controls in place to manage finances; and were actively managing the risks, taking appropriate action where necessary to mitigate the impact on the charity. The aim was also to identify common risk factors in these types of cases to inform future risk assessment and highlight good practice in dealing with financial distress where this was identified.

The commission is prohibited from interfering with the management and administration of charities, therefore it cannot directly intervene to save a charity that has failed to achieve its aims, is in financial distress or is at risk of closure - that is the responsibility of trustees. However, we will remind trustees of their legal duties, and provide regulatory advice to trustees or take enforcement action when we find trustees have failed to comply with their duties and exposed a charity, and its assets, to significant undue risk.

About the charities

Ten charities were identified which showed signs they may be at risk of financial distress. Five of these charities had an 'emphasis of matter' in the independent auditor's report alerting the commission to a potential issue. The others were identified as the charity triggered one or more of the following risk factors:

- insolvency
- low levels of or no financial reserves
- staff redundancies
- downsizing premises
- negative pension funds

The 10 charities selected covered a range of charitable purposes including education, health, leisure, the arts and science. Most were heavily reliant on grants, in particular from local or central government.

The commission's regulatory engagement with some of these charities is still ongoing therefore they are not named in this report.

The action the commission took

The commission's accountancy team carried out a scrutiny of accounts for those charities with a declared annual income of over £1 million which included an 'emphasis of matter' paragraph about 'going concern' as a way of identifying large charities that may be in financial difficulty. We have published a report '**Charities with audit reports identifying that they may be in financial difficulty**'. From this list, 5 charities assessed as being at high risk of financial distress were selected for further regulatory engagement.

Five additional charities were selected after reports suggested they were taking steps to resolve financial difficulties similar in nature to Keeping Kids Company, which we assessed as potentially high risk. The accounts of these charities were also scrutinised by the accountancy team.

We opened monitoring cases for each of the 10 charities and carried out desk based analysis and research alongside the accounts scrutiny. We met with the trustees and/or liquidators of the charities to discuss the charity's financial position and the actions being taken. We verified the information and assurances provided by the charities using relevant methods, including contacting third parties and requesting and reviewing supporting documentation.

What the commission found

All of the charities in this sample were found to have experienced financial distress.

A majority of the charities clearly demonstrated they had taken proactive steps to resolve their financial issues prior to the commission's engagement. We were reassured that, on the whole, trustees were alert to changes in their charity's financial stability through good financial procedures and reporting mechanisms. By spotting financial issues early, trustees were able to take a range of relevant actions to improve the position before it reached a crisis point. The trustees demonstrated they had taken difficult decisions in a timely manner to manage their charity out of the period of financial strain.

Examples of the actions taken by trustees of these charities included:

- reviewing their current operations and taking tough decisions about restructuring, stopping some activities or changing their business model
- reducing spending plans
- disposing of property assets or reducing premises costs in other ways
- seeking alternative revenue sources
- building up appropriate financial reserves
- seeking a merger or collaborative working to enable the charity's services to be provided on a more stable financial footing in future

Other good practice steps included:

- more regular trustee or finance committee meetings during intense phases when decisions needed to be taken quickly
- ensuring charity trustees and senior management regularly received and considered robust, up to date financial management information
- keeping financial plans under regular review and making adjustments as necessary to deal with changing circumstances

The commission analysed the various factors that had contributed to financial distress in each of the charities. The majority had experienced a loss of revenue due to factors outside of their control, such as expiry or withdrawal of grants from local and central government agencies. The difference between the charities which were able to address these issues, and those which were not, was whether they identified and responded to these changes early. In one case, a charity has currently suspended all activities whilst it reviews its future viability but by reacting quickly it was able to do this in an organised manner without the charity becoming insolvent.

In 2 charities, there were signs that poor governance and a lack of financial oversight by trustees meant the charity was not able to identify and respond to changes in funding at an early stage. These charities had become insolvent before the commission engaged with them. Another charity had been through a long period of financial instability, becoming heavily reliant on loans, and was at risk of becoming insolvent if it did not put more sustainable funding plans in place.

Specific factors which contributed to the financial issues in these cases included:

- a lack of financial information being provided to the trustees by staff, and a failure by the trustees to obtain this information
- failure to maintain adequate accounting records
- trustees not meeting on a regular basis to take decisions collectively
- a lack of financial planning
- a failure to critically review income generation methods

Impact of the commission’s involvement

The commission issued general advice and guidance to 7 of the charities, which had recognised there were problems early and taken appropriate action. The commission is still engaged with 1 of these charities as it seeks alternative funding sources. We have **published 3 case reports** on the action taken by some of the charities that improved their financial situation. It is hoped that this will highlight some good practice and be useful for charities which may be in a similar position on the steps they can take if they find themselves in financial difficulty.

Two of the charities had already commenced insolvency proceedings when the commission engaged with them.

An action plan[1] was issued to one charity requiring improvements in governance and financial management, giving the trustees a specific time period in which to take actions to improve the situation and ensure they comply with their duties.

We are engaged in ongoing regulatory action in these 3 cases and will publish case reports on them in due course.

We are also using the findings from this work to feed into the revision of our suite of guidance on managing finances and reserves.

Lessons for other charities

This analysis highlighted the impact of changes to funding within the sector in the past few years, in particular the reduction in local and central government grants.

Those charities which were alert to and recognised changes in their financial profile early, and quickly took proactive steps to deal with them, were generally able to effectively manage financial stress. Our **15 questions trustees should ask** helps trustees focus on the issues they may need to address in future. Having effective systems in place to help their trustees and senior staff identify financial risks is also essential early on. Trustees can use our guidance on **planning for and managing financial difficulties** to check that they have the basics in place to address possible changes in the economic environment in which the charity is operating.

This further underlines the importance of trustees putting robust policies and procedures in place, including setting and building up appropriate financial reserves, taking into account the risks and impact of unplanned closure associated with their business model on their beneficiaries (in particular vulnerable beneficiaries), staff and volunteers, their spending commitments, potential liabilities and financial forecasts.

Some of the proactive steps taken by charities included measures such as reducing spending plans, disposing of property assets and seeking alternative revenue sources. Collaborating or merging with another charity, or even winding the charity up, are also options that charities should be ready to use, as demonstrated in the report.

1 Regulatory advice pursuant to section 15(2) of Charities Act 2011 - making clear that if steps are not taken, the trustees risk being in breach of their legal duties as charity trustees in the administration of the charity.