

PKFLITTLEJOHN



Kids Company

Review of Financial and Governance Controls

March 2014

Contents

1	Executive summary	2
2	Recommendations	4
3	Policies and procedures	9
4	Governance	11
5	Management accounting	14
6	Purchasing and procurement	19
7	Payroll	20
8	Financial systems	23
9	Forecasting	29

1 Executive Summary

1.1 Background

PKF Littlejohn was successful in a public tender issued by the Cabinet Office to undertake a review of governance systems and financial controls at the Kids Company. Our work was conducted at the head office of the Kids Company, based in Southwark, and our findings are based upon this work which consisted of discussions, substantive testing and performing walkthrough tests.

1.2 Report structure

This report has been structured around the agreed schedule of work. A summary of recommendations arising from our work has been included at section 2, along with the response of management.

Throughout this report we have referred to the Kids Company as "the Charity".

1.3 Findings

Our review was conducted in January 2014 and this report reflects the systems existent at that time. The responses from management, set out in section 2, reflect the position as at 19th February 2014. We have not verified the position at this time and cannot, therefore, confirm whether stated changes are in place.

Our work did not include an examination of all of the Charity's procedures and controls. We have only considered matters that have come to our attention as a result the work conducted in accordance with the tender document issued by the Cabinet Office "RM2668-L0170 Independent Review of Financial and Governance Controls" and consequently our comments should not be regarded as a comprehensive record of all weaknesses that may exist or of all improvements that might be made.

1.4 Conclusions

Our conclusions on each area reviewed are as follows:

Area	Conclusion
Policies and procedures	There are comprehensive policies and procedures at the Charity. Some minor recommendations for system improvement have been identified.
Governance	The governance system in place at the Charity appears to be appropriate for its size and complexity. We have no recommendations to make in terms of improvements to the governance systems and risk assessment process.
Management accounting	There is regular reporting of performance to Trustees through the Board and Finance Committee. Recommendations have been made to further improve the information provided.
Purchasing and procurement	Procedures for purchasing are followed and no significant issues were identified.
Payroll	There are no significant weaknesses in the payroll system, only minor improvements have been recommended.

Financial systems	Given the wide range of income and expenditure there are reasonable controls over the systems capturing and reporting income and expenditure. We have made recommendations to strengthen controls.
Forecasting	Both strategy and business planning are appropriately managed, however, this must be considered in light of the serious cashflow position that the Charity often finds itself in.

It is clear from our work that the main financial risk to the organisation is cashflow. We understand that a significant amount of management and finance time is spent in assessing and managing the cash position. Without improving the cash position of the Charity it is not possible to build reserves and invest in new activities and locations.

We would like to take this opportunity to thank the staff and Trustees of the Charity for their time and assistance during our review.



PKF Littlejohn LLP

3 March 2014

2 Recommendations

Our recommendations have been ranked in terms of priority with '1' being most important and '3' least important.

Recommendation	Priority	Recommended timing of implementation of recommendation	Response from Kids Company as at 19 th February 2014
Policies and Procedures			
We recommend that consideration should be given to referring to the Working Time Regulations within the Staff Handbook.	3	12 months	Completed.
We recommend that the Staff Handbook is updated to reflect pension scheme arrangements when they are implemented.	1	3 months	Completed.
We recommend the seven statutory duties of a Director, as set out in the Companies Act 2006, are included within the Financial Procedures Manual.	3	12 months	Completed.
The Financial Procedures Manual should be updated to correctly refer to HMRC rather than the Inland Revenue.	3	12 months	Completed.
We recommend that the Financial Procedures Manual is updated to include reference to the Charity's practice of utilising the HMRC online self assessment tool.	2	6 months	Completed.
We recommend that the Financial Procedures Manual should be updated to include procedures in relation to the production of management accounts and cash flow	1	6 months	Completed.

Recommendation	Priority	Recommended timing for implementation of recommendation	Response from Kids Company as at 19 th February 2014
forecasting and management.			
Management Accounting			
<p>We recommend that the management accounts include a forecast outturn for the projected year end results. This should reflect anticipated payroll costs, kids costs based on current trends and expected income levels based on the probability of donations and other sources of income being received.</p>	1	6 months	This procedure had already been agreed, and is now completed.
<p>We recommend that the management accounts should include a forecast of the cashflow for the next twelve months.</p> <p>This will provide information for the Trustees to identify, in advance, those periods where net cash outflows mean that meeting liabilities as they fall due is difficult. The Trustees should ensure arrangements are in place to meet liabilities, be it through additional borrowing, bearing in mind future cashflow implications, building up cash reserves, increased fundraising or restricting expenditure.</p>	1	1 month	Completed.
<p>We recommend that the management accounts should include a comparison between the restricted fund balances and restricted fund bank balances. This will enable the Finance Committee to establish the level of unrestricted expenditure met from restricted fund cash.</p>	2	6 months	Completed.

Recommendation	Priority	Recommended timing for implementation of recommendation	Response from Kids Company as at 19 th February 2014
<p>We recommend that the management accounts disclose:</p> <ul style="list-style-type: none"> o Debtor balances over one month old o Creditor balances which are over one month old 	1	6 months	This had already been agreed, and is now completed.
<p>We recommend that care is taken when reporting to funders to ensure that actual costs incurred in completing the project are reported and can be reconciled back to the project cost analysis. We identified one instance where the amount reported exceeded the costs reflected in the project analysis.</p>	1	3 months	<p>Reports to funders are based on actual costs incurred in completing the project at the point of reporting, and can be reconciled to the nominal ledger. We will continue to ensure this happens in the future, and are investigating the error identified.</p>
<p>We recommend that only cash costs are included in the calculation of expenditure claimed from the Cabinet Office, excluding gifts in kind.</p>			<p>Kids Company have not claimed any funds which we have not directly paid ourselves.</p> <p>Gifts in kind have been included at the start of the calculation as part of the total expenditure of Kids Co, however as documented in our claim, our methodology is to only allocate a percentage of that total to the costs of delivering the grant, and only a proportion of that is subsequently claimed.</p> <p>In calculating the percentage appropriate to allocate we have included GIK in our assessment of the whole of our delivery costs. However we are not asking the Cabinet Office to reimburse us for funds we have not ourselves spent.</p> <p>If the Cabinet Office would prefer us to exclude GIK costs at the start of the calculation, we will be happy to re-assess our percentage estimate (applied to net costs rather than gross</p>

Recommendation	Priority	Recommended timing for implementation of recommendation	Response from Kids Company as at 19 th February 2014
			costs) and report accordingly going forward.
Purchasing and procurement			
We recommend that consideration is given to implementing a purchase ordering system. This provides control in identifying who has committed expenditure, and also provides an indication of the committed liabilities at any point in time where an invoice has not been received.	2	6 months	As noted in the report, very little of Kids Co's expenditure would go through a purchase ordering system (less than £200,000pa or 1% of our expenditure). Because of the additional resource required to implement a purchase ordering system at present, and the low risk of continuing to use the current system, we consider that implementation would not generate sufficient return to justify the investment. We aim to continue to keep Kids Co's administrative costs below 10%, so that most of our resources go straight to our beneficiaries.
Payroll			
We recommend that payments are made to HMRC by 19 th (for cheques) or 22 nd (for BACS) of each month to meet prior month PAYE liabilities. There is a risk, should delays in payment continue, that HMRC requests a security payment. There is a risk that continued delays in paying monthly liabilities may result in HMRC seeking full recovery of debts without offering a repayment schedule.			
We recommend that correspondence in resolving payroll queries is retained as a full audit trail of the authorisation of the monthly payroll, in addition to that already held on file.	2	3 months	Currently staff retain correspondence on file that evidences the financial changes in the payroll, and not correspondence with the payroll provider correcting errors etc once these have been resolved. Confirmation of the expected figures is provided to us as the preview payroll. We feel that this is sufficient for audit purposes and that including correspondence not directly evidencing the financial

Recommendation	Priority	Recommended timing for implementation of recommendation	Response from Kids Company as at 19 th February 2014
We recommend that the pre-employment checklist, once completed, is approved by the Director of human resources to evidence satisfactory completion of all the required checks prior to offering an individual employment with the Charity.	2	6 months	changes would make the file less efficient and effective. Completed.
Financial Systems			
We recommend that there is formal, documented review of invoices prior to issuing. This relates to invoices raised in the Charity and in the trading subsidiary.	3	6 months	Completed.
We recommend that all loans are, at a minimum, confirmed in writing in order to minimise the risk to the Charity of its reputation being damaged due to any misunderstandings. Consideration should be given to having a proforma loan agreement that could be used. This would set out key aspects such as the repayment schedule and interest rate.	1	6 months	We will document the terms of all future loans in writing.
Forecasting			
We recommend that the cashflow spreadsheet is reviewed and responsibility for completing the document assigned to members of staff along with deadlines for completion. This will provide a more accurate short term assessment of the cash position.	1	3 months	We note that the timing of the audit work meant that an unreconciled version of the cash flow forecasting sheet was reviewed. We confirm that individual staffdo have clear responsibilities for completion, together with deadlines, and that this process is reviewed, meaning that each week starts with a reconciled cash flow forecast. This is documented in our updated finance procedures manual.

3 Policies and procedures

3.1 Scope of review

- Review existing documented policies and procedures, comparing to best practice.
- Identify areas where a policy or procedure could be introduced as none currently exists.

3.2 Work performed and results

Our work consisted of reviewing the policies and procedures in place at the Charity, comparing to best practice and the requirements of the Charity. Department Heads are responsible for those policies and procedures applicable to their department. Approval of updated and amended policies is the responsibility of the Governance Committee, with the exception of the Financial Procedures Manual which is the responsibility of the Finance Committee.

Policies and procedures are sourced in three key documents:

- Policy Handbook
- Staff Handbook
- Financial Procedures Manual

Policy Handbook

This document applies to all staff and volunteers. The Handbook contains those policies and procedures that relate predominantly to child protection and safeguarding. Included within the Handbook are the contact details of the Head of Safeguarding. Given the specialist nature of these policies and procedures, we are not suitably qualified to comment on their completeness.

Staff Handbook

The Staff Handbook is a comprehensive document which sets out the main policies and procedures applicable to all staff, irrespective of the area of the Charity within which they work. We reviewed the contents and all key policies to assist and protect staff are included, such as whistle blowing, fraud etc.

The Handbook refers to a pension scheme being available from 1 January 2014. The Handbook should be updated to reflect the implementation of the scheme and conditions attached.

Financial Procedures Manual

The Financial Procedures Manual was reviewed and updated in December 2013. The Manual includes:

- Confirmation of the financial responsibilities of Trustees
- Role of the Finance Committee
- Process of compiling and approving the annual plan and budget
- Reserves policy
- Identification process for conflicts of interest and treatment of gifts
- Controls over income
- Controls over expenditure
- Controls over financial assets
- Controls over physical assets
- Payroll procedures
- Guidance on establishing whether individuals are employed or self-employed

The Manual reflects that there is no purchase order system in place, control over costs is exercised through the approval process when invoices are approved within a pre-approved budget. A schedule setting out the approval thresholds for expenditure is documented.

There is a requirement to perform monthly reconciliations of the cash book, purchase ledger, sales ledger and payroll control. The cash float is required to be reconciled on a monthly basis.

Section X.E of the Manual relates to payments to Inland Revenue. Technically this should refer to Her Majesty's Revenue and Customs (HMRC). The policy is that payments in respect of PAYE should be made monthly. This policy has not always been complied with, resulting in a liability to HMRC arising and a repayment profile agreed with HMRC.

The procedure in relation to staff loans requires that once a year, at the financial year end, each employee in receipt of a loan should sign a statement of the loan position at that date. In addition, there is a formal agreement setting out the amount and repayment profile, signed by both the employee and an appropriate Charity representative.

The Manual does not include any policies or procedures relating to:

- Cash flow management and the process for forecasting cash flows on a short and long term basis.
- Production of management accounts

3.3 Conclusions

From our review there are comprehensive policies and procedures at the Charity. Our testing of systems, as reported in other sections, found that policies and procedures are predominantly followed in practice.

Some minor recommendations for system improvement have been identified.

3.4 Recommendations

- We recommend that consideration should be given to referring to the Working Time Regulations within the Staff Handbook.
- We recommend that the Staff Handbook is updated to reflect pension scheme arrangements when they are implemented.
- We recommend the seven statutory duties of a Director, as set out in the Companies Act 2006, are included within the Financial Procedures Manual.
- The Financial Procedures Manual should be updated to correctly refer to HMRC rather than the Inland Revenue.
- We recommend that the Financial Procedures Manual is updated to include reference to the Charity's practice of utilising the HMRC online self assessment tool.
- We recommend that the Financial Procedures Manual should be updated to include procedures in relation to the production of management accounts and cash flow forecasting and management.

4 Governance

4.1 Scope of review

- Review the role and responsibilities of Trustees.
- Review the process for recruiting Trustees.
- Review the process governing the identification of, and monitoring of transactions with, related parties, including Trustees.
- Review the terms of reference for committees.
- Review the risk assessment identification, monitoring and review process.
- Report of governance controls and procedures benchmarking against current best practice.
- Interaction with trading subsidiary.

4.2 Work performed and results

A meeting was held with the Vice Chair, Head of Finance Committee and Head of Governance Committee during which a range of matters relating to the role of the Board and Committees was discussed. A meeting was also held with the Chief Executive to discuss the relationship and interaction with the Board from the point of view of senior management.

Governance structure

The ultimate body responsible for the activities and decision making with the charity is the Board of Trustees. As a charitable company limited by guarantee the responsibilities of the Board are defined in both charity and company law. The charity's governing documents are its memorandum and articles of association.

Supporting the Board are three committees:

- Finance committee – responsible for financial matters
- Governance committee – responsible for policies, procedures and operating issues
- Development committee – responsible for fundraising

It has been recognised by the Trustees that the rapid growth of the Charity in recent years has not been mirrored by developments in the governance structure and it is only recently that actions have been taken to strengthen the senior management team and reporting to and from the Trustees. Discussions with Trustees and the Chief Executive indicated that the current structure is sufficient to meet the needs of the Charity's operations and facilitate effective decision making.

Board of Trustees

There are currently seven trustees, who are also the members of the charitable company for the purposes of company law. There is a process underway to recruit an additional three or four new Board members.

The Board meets at least six times, though the expectation is that Trustees will be involved on a much more regular basis through involvement in committees and in participating in the Charity's activities.

New Trustees are appointed based on skills and experience to either complement existing Trustee skill sets or to bring additional skills not currently on the Board. The key skill areas of finance,

legal, human resources, media and communications and fundraising are all currently demonstrated at Board level. In addition to skills and experience new Trustees will bring, there is also a need for prospective Trustees to empathise with the objectives of the Charity.

There are no requirements within the governing documents regarding how long Trustees can stay on the Board. This ensures that institutional knowledge and experience is not lost, however, this can also mean new ideas and impetus, brought by change, are not being benefited from. Adding new Trustees, as is underway, will address this issue.

Potential Trustees are initially identified from within the Board itself through contacts and recommendations, or through the Charity's key supporters. Should appropriate individuals not be found through this process, the Board will advertise externally. It is important to the Trustees that new Board members will be prepared to "roll up their sleeves and get their hands dirty".

A full induction pack is provided to new Trustees incorporating background information on the Charity, Charity Commission guidance on being a Trustee, other relevant sector guidelines and the latest financial information. New Trustees spend time with the teams within the Charity to gain an understanding of the day-to-day activities, structure and responsibilities within the organisation. They are also required to visit the various centres and projects to fully appreciate what the Charity does and the beneficiaries it supports. Ensuring such involvement in understanding the Charity's activities is particularly good practice in enabling Trustees to consider the implications of their decisions.

All Board members are required to undergo DBS checks. They are also required to complete declaration of interest forms to ensure that all related parties are identified. Where there is a potential conflict of interest during a decision at Board level, the individual conflicted will leave the meeting and not participate in discussions. This is good practice.

The Board and all Trustees participate each year in a process of self review. Template forms are circulated to cover:

- Board effectiveness
- Chair effectiveness
- Committee effectiveness
- Self review and assessment

Such review is common in codes of good corporate governance but rarely is it applied in the charity sector. We are pleased to see such a review taking place.

Committees

Terms of reference exist relating to the Finance and Governance Committees, setting out each Committee's responsibilities. From discussions with the Heads of each Committee, these appear to properly reflect the work of the Committees and covers all aspects of what such a body should do. The terms of reference are reviewed annually.

The Finance Committee meets around nine times each year, although there is often regular communication outside of the meetings between members of the Committee and with the senior management team, in particular the Accountability and Finance Director. Four Trustees sit on the Committee with members of the senior management team in attendance. At each Committee meeting the latest management accounts are reviewed, with focus on particular areas such as staff costs, head count and kids costs. The Finance Committee is responsible for approving the Financial Procedures Manual and liaising with the external auditors.

The Governance Committee meets around eight times a year and reviews reports from the main areas within the Charity, presented by the Heads of the various departments. In particular human resources, clinical and operations are focussed on. The Governance Committee is responsible for reviewing and approving all policies and procedures other than the Financial Procedures Manual.

Risk assessment process

The Governance Committee is responsible for the risk register. The Accountability and Finance Director is the senior management team member responsible for compiling the risk register through liaising with other Heads of departments to ensure that all risks are captured. Each risk is assessed in terms of likelihood and impact, with a member of staff, or on occasion the Board, assigned responsibility for ensuring that sufficient mitigating controls are in place.

Trading subsidiary

The trading subsidiary has only recently been established. Its purpose is understood and the Board are investigating how to increase the amount of commercial activity, and income, that can be generated by the Charity, to be channelled through the subsidiary.

4.3 Conclusion

The governance system in place at the Charity appears to be appropriate for its size and complexity.

Board and Committee responsibilities are well documented and, more importantly, understood.

We have no recommendations to make in terms of improvements to the governance systems and risk assessment process.

5 Management Accounting

5.1 Scope of review

- Review the content of the management accounts.
- Agree the management accounts back to the underlying accounting records.
- Review the process of producing management accounts.
- Review the process for identifying restricted income and expenditure.
- Ascertain the basis for allocating costs to projects.
- Review accounting policies and compare them with UK Generally Accepted Accounting Practice.
- Reporting process to funders.

5.2 Work performed and results

Management accounts

The finance department is responsible for producing the management accounts. Management accounts are produced on a monthly basis with the aim of finalising by the 10th of the following month. The management accounts for November 2013, being the latest available at the time of our initial visit, were used as the basis for our review. These contained the following information:

- High level summary of income and expenditure comparing actual to budget year to date and providing comparative information for at the same time in the previous year.
- Income for the month and year to date, allocated between: Trusts, Corporate, Individual, Events and Campaigns, Government and Other contracts.
- Analysis of restricted income and expenditure as at year to date with a column to reflect over and underspends. In practice, only underspend on restricted projects is reported as unrestricted funds meet any deficits. Given the nature of the Charity's activities, it is not appropriate to manage each restricted donation as a full project.
- Expenditure is reported by cost centre, which are set as: Ops and Facilities, Centre Clinical Projects, Arches, Urban Academy, Camden, Heartyard, Bristol and Schools. The expenditure is further analysed, actual against budget year to date, between staff costs, kids costs and running costs.
- There are more detailed schedules of the expenditure incurred in each cost centre comparing actual to budget for the month and the year to date. The year to date figure for the prior year is also provided for each category of expense.
- Narrative explanation of significant variances is provided.

We reviewed the November management accounts and attempted to reconcile these back to the trial balance. The initial trial balance we were provided with differed by £408,000 due to income recognised incorrectly in a balance sheet code on the trial balance. A second trial balance was produced that did agree to the management accounts. There was an anomaly between the second trial balance provided and the management accounts in that £63,000 of restricted income (Morgan Stanley), recorded in the trial balance, was not reflected in the list of restricted income in the management accounts.

Restricted income and expenditure

Charities need to ensure that controls exist to provide assurance that any monies received with restrictions attached by donors are spent only on those purposes for which the funds were given. Key to this is recording, at the time of receipt, any donor wishes.

The process to identify restricted donations is as follows:

1. Income is received and the Finance Officer contacts the fundraising team for details of the donation. Donations are then categorised initially as:
 - a. Individuals
 - b. Trusts
 - c. Corporate
2. If there are no restrictions attached the donation is recorded as general income in the accounting ledgers, i.e. unrestricted. Large donations (>£5,000) are recorded to be included in the year end Major Donors list.
3. If there are restrictions, irrespective of the value, the income and nature of restriction are recorded on the grant summary spreadsheet. Each donation has a separate tab on the spreadsheet which allocates income received from the donor (if more than one donation under the same restriction) and costs allocated against the income.
4. There are three restricted income categories in the nominal ledger, one each for individuals, trusts and corporate.
5. Files are maintained containing the supporting documentation for large unrestricted donations and all restricted donations.

A sample of restricted income transactions were selected at random and tested as follows:

- o Agreed to the grants summary spreadsheet
- o Agreed to the management accounts
- o Agreed postings to the nominal ledger as being recorded in restricted income

No issues were identified.

The highest value expense to the Charity is payroll costs. Where restricted income funds salary costs the Finance Officer identifies these from payroll and allocates, via the grant summary sheet, to the restricted income. The key risk here, therefore, is that the same employee could be charged to two different restricted income sources. In order to ensure this does not happen, the Finance Officer records on a staff list spreadsheet whether their salary is funded by a grant or not.

Given that the allocation of costs to restricted funds occurs outside of the accounting ledgers, there is a risk that some expenditure could be allocated to more than one restricted fund. Our substantive testing did not identify any instances of costs being claimed by more than one project.

Allocation of costs to projects

The cost centres and the costing module in Dimensions are both used. This allows the expenditure on children (allowances, vouchers, treatments etc) to be manipulated through Excel into the correct location category. The reference numbers in the costing module match up to the reference codes in the Aurora information system, which contains details of all beneficiaries including treatment, personal details.

Review of accounting policies

The Charity must apply United Kingdom Generally Accepted Accounting Practice ("UK GAAP") when preparing its financial statements. The application of UK GAAP to the charitable sector is set out in the Statement of Recommended Practice by Charities (issued in March 2005). The recognition criteria for incoming resources, as set out in the SORP, is (para 94):

"Incoming resources – both for income and endowment funds – should be recognised in the Statement of Financial Activities when the effect of a transaction or other event results in an increase in the charity's assets. This will be dependent on the following three factors being met:

- (a) Entitlement – normally arises when there is control over the rights or other access to the resource, enabling the charity to determine its future application;*
- (b) Certainty – when it is virtually certain that the incoming resource will be received;*
- (c) Measurement – when the monetary value of the incoming resource can be measured with sufficient reliability."*

The current accounting policy of the Charity, as set out in the 2012 financial statements, is to recognise pledges made before the year end but cash not received at the year end. At the point the pledge is made it is a matter of professional judgement as to whether the Charity has met the entitlement criteria. We have not reviewed prior year transactions, or those at 31 December 2013, to fully assess the application of the policy. We did review the balance sheet as at 30 November 2013 and investigated balances included in debtors. Of these income had been recorded in prior years for the following, still not received:

- 2011 - £150,000 remains outstanding from the sale of a painting. £50,000 has been received, the balance is considered recoverable by the Charity.
- 2012 – in December 2013 an amount of £146,000 was written off as not recoverable despite being recorded as income in 2012.

We understand that the accounting policies are reviewed by the Trustees, through the Finance Committee, on an annual basis when preparing the financial statements.

Reporting to funders

We reviewed the reporting process for two grants as follows:

Government grant

The report provided to the Cabinet Office for the quarter ended 30 September 2013 was reviewed. The basis of reporting is based on generalised percentages across the Charity's expenditure rather than direct costs incurred in fulfilling the grant agreement outputs. We understand this has been documented in submissions to the Cabinet Office.

We reviewed the September claim and make the following observations:

- the calculation of accommodation costs includes gifts in kind, which is not a cash transaction and should therefore be excluded.
- costs for the month of September are estimated, based on an average of the previous two months, rather than actual costs. We understand this is a function of the timing of reporting to the Cabinet Office. This is noted in the report to the Cabinet Office.

From our review of the grant agreement, and in particular the Department for Education terms and conditions, as referred to in Annex A of the grant agreement, there are particular conditions that the Charity ought to bear in mind in decision making and responsibility to report to the Cabinet Office. In particular, these are:

"13.2 You should be able to demonstrate that the systems of financial and manpower control, management and organisation will enable you to meet the objectives of this Grant Funding Agreement."

"13.3 You must comply with the recommendations of the Public Accounts Committee and any other expenditure controls specified by Government."

"13.4 – You must inform the Department immediately if you are experiencing any financial difficulties or any delays which could impact on your ability to deliver the funded activities set out in the Grant Funding Agreement."

"15.1 – You must obtain prior written consent from the Secretary of State before:

- Borrowing or lending money from any source;
- Charging any asset or security; and
- Giving any guarantees, indemnities or letters of comfort

That relate to any of the conditions of this Grant Funding Arrangement, or have any impact on your ability to deliver the funded activities set out in the Grant Funding Agreement."

Credit Suisse grant

The report provided to Credit Suisse in respect of 2013 was reviewed. It was noted that the financial information included in the report did agree to the restricted fund working presented for the period or the allocation of staff on the staff list.

5.3 Conclusions

Trustees have a legal duty to:

- safeguard the assets of the charity and ensure proper application of resources
- maintain adequate accounting records that explain all transactions and show the charity's financial position.

Accurate management accounting enables the Trustees to discharge these duties. One of the key aspects of charity accounting and financial reporting is the recording of restrictions on donations and fulfilment of the attached conditions as set by the donor.

A significant amount of work is performed, and information manipulated, outside of the accounting ledgers to record income received and expenditure allocated to restricted funds. Given the diverse range of restrictions that were noted on income, it would be difficult to construct the accounting ledgers within Dimensions in such a way as to project account within the general ledger. Unless investment is made in a bespoke reporting package, there are no major improvements that can be made to the current system.

The information provided in the management accounts is appropriate for an organisation such as Kids Company. The key financial risk is cashflow, which should be a prominent part of the reporting.

5.4 Recommendations

- We recommend that the management accounts include a forecast outturn for the projected year end results. This should reflect anticipated payroll costs, kids costs based on current trends and expected income levels based on the probability of donations and other sources of income being received.
- We recommend that the management accounts should include a forecast of the cashflow for the next twelve months.
- We recommend that the management accounts should include a comparison between the restricted fund balances and restricted fund bank balances. This will enable the Finance Committee to establish the level of unrestricted expenditure met from restricted fund cash.

- We recommend that the management accounts disclose:
 - Debtor balances over one month old
 - Creditor balances which are over one month old
- We recommend that care is taken when reporting to funders to ensure that actual costs incurred in completing the project are reported and can be reconciled back to the project cost analysis. We identified one instance where the amount reported exceeded the costs reflected in the project analysis.
- We recommend that only cash costs are included in the calculation of expenditure claimed from the Cabinet Office, excluding gifts in kind.

6 Purchasing and procurement

6.1 Scope of review

- Review ordering process including authorisation procedures in place.
- Review procurement procedures and test a sample of high value transactions for compliance with tendering procedures.
- Review a sample of existing relationships with suppliers to ascertain if a contract for services is in place.

6.2 Work performed and results

As the Charity does not operate a formal purchase order system, at any time there is no record of the liabilities extent from committed purchases – this is only established when the invoice is received. The implementation of a purchase order system would enable budget holders to formally authorise an expense prior to the commitment being made and assist with managing budgets and cash flow as this would reduce the time taken to record expenses.

The main items of expenditure in the Charity are payroll, use of self employed consultants and allowances for children. There is rarely high value procurement, such as capital expenditure, undertaken. As a result, our testing was limited to compliance with normal authorisation and approval levels which is reported in section 8.

6.3 Conclusions

Given the main categories of expenditure, high value ancillary expenditure is uncommon and our testing was therefore limited in this area.

Our general testing on expenditure, reported elsewhere, did not identify any issues.

We have made one recommendation regarding a system improvement.

6.4 Recommendations

- We recommend that consideration is given to implementing a purchase ordering system. This provides control in identifying who has committed expenditure, and also provides an indication of the committed liabilities at any point in time where an invoice has not been received.

7 Payroll

7.1 Scope of review

- Undertake a walkthrough of two months' payroll, agreeing:
 - o Control account reconciliations
 - o A sample of employee payments to contracts of employment
 - o A sample of deductions (PAYE and NI) for accuracy
 - o Payment of salaries and deductions to employees and HMRC
 - o Sample of relevant staff for Disclosure and Barring Service checks.

7.2 Work performed and results

The payroll function is outsourced to 'Moore Pay'. The monthly payroll process is as follows:

At the end of each month two files are prepared:

1. Payroll changes file, detailing the following:
 - Salary changes
 - Non Salary changes (change of address, bank details etc)
 - Joiners
 - Leavers
2. Payroll summary file

The human resources department informs the finance team of the changes for the month. Two Finance Officers are responsible for administering the payroll information. They alternate the processing of the payroll each month in order to maintain complete knowledge, so that there are no issues should one Finance Officer fall ill or leave.

A payroll spreadsheet is produced which is sent to Moore Pay each month by the finance team. The spreadsheet lists all changes (e.g. salary increases, leavers) and a 'joiner form' is completed for each new starter. This contains similar information to the Charity's human resources form, but is tailored to meet Moore Pay's needs.

Once the payroll spreadsheet has been produced, the second Finance Officer will review the sheet against the changes file prior to the sheet being sent to Moore Pay. When the sheet is submitted members of human resources, the Finance Officers and the Finance Manager are copied to the correspondence enabling them to review the initial submission if they desire, though there is no formal requirement.

On the 21st/22nd of the month, Moore Pay sends the "Preview Payroll" information for review. This is reviewed by the Finance Officer who is responsible for payroll that month, alongside a member of the human resources team. They will check that the changes have been correctly applied by Moore Pay, and will query any discrepancies by email until they are resolved. The email trail resolving queries is not printed, but retained in the inbox of the individual clearing the query.

The final run is processed by Moore Pay on the 24th ready for payment on the 27th. This is sent to the finance team and is then reviewed by finance and human resources staff in the same manner as the Preview Payroll. Any amendments which need to be made, either due to a Moore Pay error or a change in info used to prepare the payroll will be recorded as a 'manual adjustment' on the Moore Pay payroll info and authorised for processing. Moore Pay will process the payroll and BACS payment to be paid on the 27th.

Moore Pay then sends a schedule of the month's payroll in paper form, with the information also available on an online portal. The information from the payroll portal is extracted and a lookup is used on the staff list to prepare the journal for posting to the accounting system.

The bank payment is reconciled against the control account to ensure that the payment is correct. We reviewed the control accounts at the end of November and all had been properly reconciled.

As at 31 December 2012, four members of staff were entitled to pension benefits following transfer of employment under TUPE from Bristol Council to the Charity. The pension contributions are calculated by Moore Pay and communicated on the monthly statements.

Payments to HMRC

Changes to payroll

New starters are recruited to either fill a new position, which will be budgeted for in the annual budget setting process, or to replace a member of staff leaving the organisation. Recruitment is the responsibility of the human resources department. The Chief Executive meets with the Director of human resources regularly and is involved if needed in any recruitment process.

Following the recruitment process, a contract of employment will be issued to the employee and two forms will be completed to capture personal information and relevant details for bank payments etc. In addition, the individual is also asked to bring in their DBS certificate for verification. The certificate number and date are recorded in a spreadsheet maintained by human resources, which is monitored to identify when renewals are required. Human resources will send internal memos to individuals to prompt the individual to renew their certificate.

A pre-employment checklist is completed, confirming that DBS has been obtained, references have been checked etc, however, there is no formal overall approval of satisfactory completion of the checklist.

We tested the addition of starters to payroll, including ensuring the correct amount was paid in the first month. No issues were found.

Leavers

Written notice of resignation is received from the individual via their line manager.

Human resources is responsible for preparing a leavers letter to confirm the last date and to calculate any accrued holiday pay due. This letter is passed to finance to make an entry in the 'changes to payroll' spreadsheet for that month, communicating the necessary information to Moore Pay in order for them to process the payroll, remove the individual from the next month's payroll and to issue a P45.

An exit interview is then held by human resources. This is considered a learning tool for the Charity to find out why the individual has left and any suggestions as to how the Charity can improve operations.

We tested a sample of leavers to the payroll to ensure that they were paid the correct amount in their final month of employment and removed from the payroll in the subsequent month. No issues were found.

7.3 Conclusions

There are no significant weaknesses in the payroll system, only minor improvements have been recommended.

7.4 Recommendations

- We recommend that payments are made to HMRC by 19th (for cheques) or 22nd (for BACS) of each month to meet prior month PAYE liabilities. There is a risk, should delays in payment continue, that HMRC requests a security payment. There is a risk that continued delays in paying monthly liabilities may result in HMRC seeking full recovery of debts without offering a repayment schedule.
- We recommend that correspondence in resolving payroll queries is retained as a full audit trail of the authorisation of the monthly payroll, in addition to that already held on file.
- We recommend that the pre-employment checklist, once completed, is approved by the Director of human resources to evidence satisfactory completion of all the required checks prior to offering an individual employment with the Charity.

8 Financial systems

8.1 Scope of work

- Perform a walk through test on each of the key financial systems to document those systems.
- Perform substantive testing on a sample of income and expenditure transactions. For example:
 - o Income
 - Agree to invoices/grant agreements/contracts for services/correspondence
 - Bank receipt
 - Income recognition in ledgers
 - Agree compliance to documented financial procedures
 - o Expenditure
 - Agree to invoice/contract for payment
 - Bank payment
 - Agree compliance to documented financial procedures
- Review debtor balances and credit control procedures.
- Review fixed asset register.
- Review a sample of journals for appropriateness and authorisation.

8.2 Work performed and results

Income

Through review of annual financial statements, management accounts and discussions with the finance team, the main income sources were identified. The systems pertaining to each income stream were reviewed, documented and then tested through walkthrough tests as follows.

Donations and grants

Donations and grants are recognised when received. The Finance Officer contacts the fundraising team and requests details of the income by email. On receipt of the details the Finance Officer reviews the supporting documentation and value. Income is categorised by type (unrestricted or restricted) and by source (individual/trust/corporate/government). Separate nominal ledger codes are maintained for each type and source.

Should the Finance Officer identify that income should be deferred to a future period, this is recorded on a deferred income sheet and a journal posted each month to defer the relevant amount to the balance sheet. Conversely, the balance sheet deferred income account is reviewed to identify any income that should be reversed into the income and expenditure account.

Government grants

Larger grants from government bodies are dealt with differently to other donations and grants. As income is typically received in advance, it forms part of the balance recorded on the deferred income schedule. Generally income is posted to the deferred account (for Cabinet office grant, Bristol council grant etc) and then released each month. The schedule also provides a reminder to the Finance Officer to invoice for tranches if necessary, as well as ensuring that income is distributed in accordance with the matching principles.

Events

Kids Company runs a number of events during the year, the largest being the gala dinner in September. A budget is prepared prior to each event with estimations of the funding to be received and the expected costs to be incurred. This budget is approved by the fundraising team.

For the gala dinner, donation requests are sent to attendees to contribute a donation in exchange for a table.

A spreadsheet is prepared to manage the income. The anticipated income is monitored against what is received, with the Finance Officer meeting with fundraising team to ensure the anticipated income is in line with expectations. On receipt, income is recorded in the accounting ledger on a similar basis to that of donations and grants.

Online donations (Just Giving ("JG") / Virgin Money ("VM"))

The Charity receives donations through JG/VM weekly in arrears. Reports are available from an online portal which are downloaded into Excel and compared to a spreadsheet of donors maintained by Fundraising in order to identify any donations in respect of campaigns, and therefore restricted e.g. "Coats for Kids". The spreadsheet is then manipulated to form a journal which can be uploaded into the accounting system. The journal posts all elements of the spreadsheet – it recognises the donations as gross, recognises any associated gift aid as well as an expense for the 5% commission element paid to JG/VM.

Placement fees

The Charity provides placements to universities that are running social care courses. The students work with the Charity for between 50 - 100 days, and are assessed by a practice assessor within the placement.

The charge issued by the Charity differs depending on whether the Charity or the university provides the assessor. An invoice is raised after the placement has been completed.

A database of the placements is maintained which shows when a placement is coming to an end. The Finance Officer is responsible for liaising with the placements team to confirm the value of invoices to be raised. This income is recorded in a separate nominal ledger account.

There is no evidence of formal review of invoices prior to sending, though we understand that the Finance Manager does review the invoice.

Commercial activities

All commercial activities are channelled through the Charity's wholly owned subsidiary, Kids Company Enterprises ("KCE"). This is a common situation in the charity sector with profits from trading activities being gifted to the parent charity as a qualifying donation under the gift aid rules.

Invoices raised in KCE have a different numbering system to ensure that they remain separate from the Charity's invoices and are therefore recorded in the correct general ledger.

The Finance Officer will receive confirmation of the invoice to be raised via email. He will raise the invoice and post to the accounting system depending on the type of income.

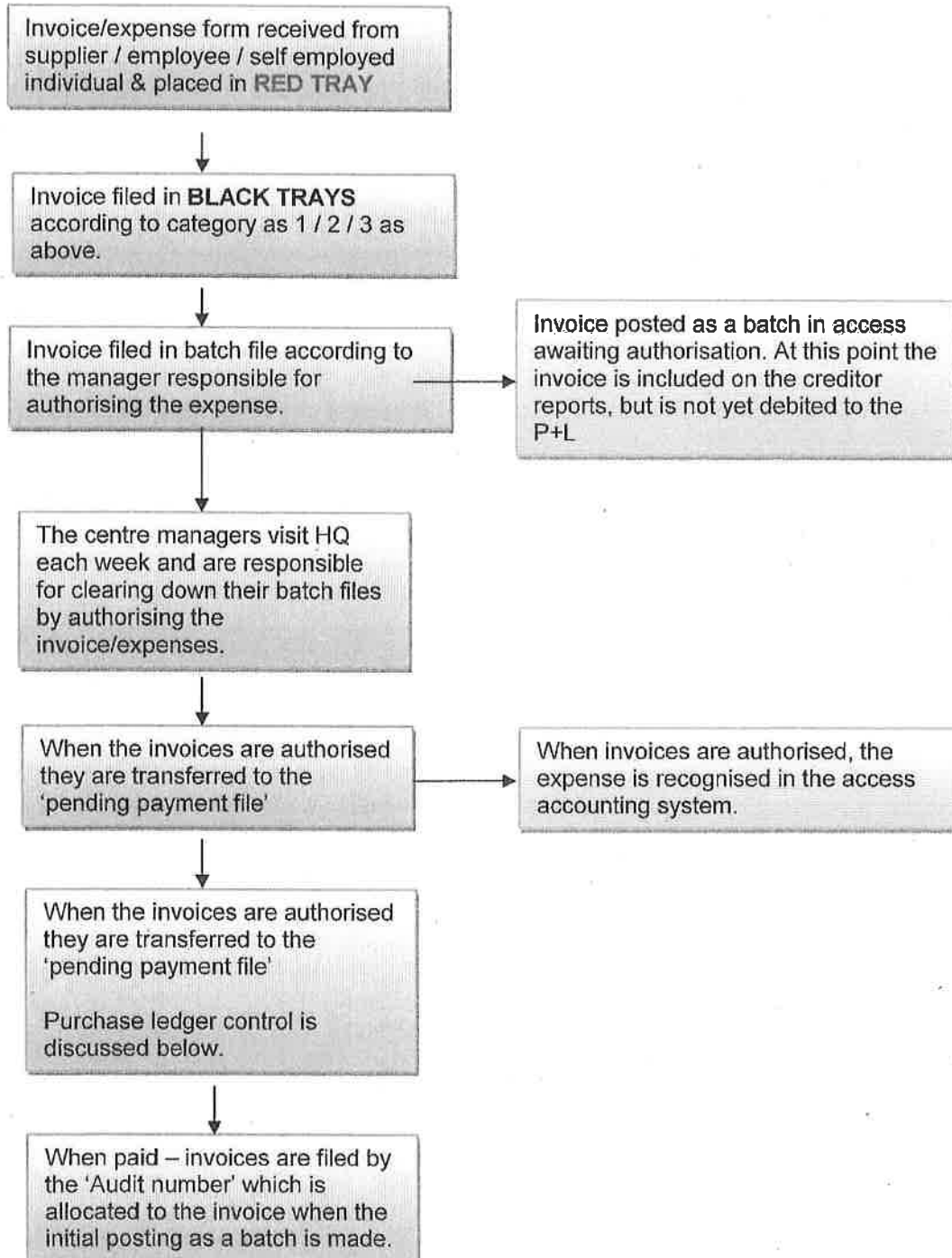
Again, there is no formal, documented review of invoices prior to sending.

Expenditure

Expenditure is posted to the accounting system based on information derived from the following sources:

1. Invoice
2. Employee expense
3. Self employed invoice
4. Cheque / payment request (where an invoice may not be available e.g. application for passport)

For items 1-3 the system is as follows



Each budget manager is responsible for the authorisation of the invoices attributable to their budget and therefore gives authorisation informally to others to purchase goods/services as required. However, this authorisation is only documented after the invoice has been received.

Invoices from **self employed** consultants are paid once per month. Invoices must be submitted and authorised by the 10th of the month to be included in the payment run at the end of the month. The Finance Officer identifies self employed invoices which are authorised at the payment run date by reviewing the aged creditor reports which break down the outstanding invoices by type i.e. corporate / staff expense / self employed.

Expense forms are paid each week for volunteers and every other week for staff expenses. When there is pressure on cash, priority will be given to reimbursing volunteers before staff.

Corporate invoices are reviewed weekly. At times during the year when cash balances are low, for example during the summer months, decisions have to be taken over supplier priority in terms of payment.

Bank payments

Unless there are only a few payments being made, BACS is used.

The BACS file is created, uploaded to the accounting system and exported into the banking system. A separate individual to that posting the transactions is required to authorise the bank payment online.

If a smaller number of payments is required, cheques may be issued as they are cheaper than BACS. The cheque is drafted by a member of the finance team then authorised by two signatories as defined in the Financial Procedures Manual.

For cheques greater than £5,000 or a BACS payment run where an individual amount is more than £5,000 the payment must be authorised by one staff signatory and one Trustee. Where a Trustee is not available to sign higher value cheques, email approval is given to split the total expense into smaller value cheques that do not require a Trustee signature. This process was reviewed and confirmed in operation,

Allowances

The Charity provides allowances to children as part of its charitable objectives. Each centre has a cash distribution day. The allowances are prepared by a member of the safeguarding department who produces a spreadsheet of the allowances due for the week. Children who are removed from the sheet are marked with red highlighting; new children are placed at the bottom of the sheet and do not have an allocated project code. Labels and receipts for the allowances are prepared to assist in distributing these to the beneficiaries.

The spreadsheet is then passed to the finance department through a shared network drive with new children allocated a project code.

A CSV journal is then prepared with credits posted to the cash account and debits to the expenditure codes as required. A fax is sent to the bank the day before the distribution as small change is needed. All allowances are prepared at HQ and placed into labelled envelopes by two members of staff who then take the envelopes from HQ to the appropriate centre in a pre-booked taxi. The children sign a receipt slip for the cash and these are retained on file for reference. Unclaimed envelopes are returned.

Food vouchers

Included on the allowances spreadsheet are food vouchers which the Charity buys from Tesco. These vouchers are treated as prepayments until distribution when the cost is included within the allowances journal.

The distribution of food vouchers is identical to allowances.

Debtor management and credit control

The majority of the Charity's income is booked on receipt and therefore receivables is generally a small balance consisting of invoices raised. Invoiced income is chased regularly and template letters are included within the Financial Procedures Manual to prompt payment after 30, 60 and 90 days. Of the invoices tested, payment was received within 30 days.

Donation requests are also sent to prompt donations in respect of events such as the gala dinner. These donation requests are reviewed regularly by finance and the fundraising team to ensure any amounts accrued in respect of these donations are recoverable.

Fixed assets

The fixed asset register as at 31 December 2013 was reviewed. The additions are logged throughout the year and are posted as they are purchased. Depreciation is posted as part of the year end procedures. Computer equipment is asset tagged and this is maintained by the ICT department.

Journals testing

We reviewed a sample of journals and did not identify any issues.

Other systems

During our onsite visit we assessed other systems considered important in the Charity's operations. These were:

Bank reconciliations

There are five bank accounts which reconciled on a monthly basis. One reconciliation had a small difference (£99.90) which has remained a consistent difference since 2012.

Cash requests

Request forms must be completed prior to cash being issued. The form records:

- Individual ordering the cash
- Individual to collect the cash and the date to be collected
- Amount
- Name of the client and the SU number
- Authorisation by budget holder

When received the individual signs the form to confirm receipt. The form is then returned along with receipts and any unspent cash.

Cash floats

Cash floats are reconciled daily with details recorded on the cash receipts spreadsheet.

Credit card

Credit card is used to make emergency payments or when it is more suitable to use the card, for example online purchases. An authorised invoice or payment request form must be completed and authorised by a manager prior to the payment being made

Statements are received monthly and are filed each month in a lever arch file. The authorised supporting invoices and payment requests are filed in support of the statement and are given a numerical reference in order to cross reference from the statement to the invoices.

The card is paid in full by direct debit each month.

Loan agreements

From time to time the Charity receives loans from supporters to assist with cashflow problems. The loans are not always formally governed, usually agreed via email. There can often be changes to the terms, for example interest being waived, and the repayment period. There is a risk, in the absence of a formal loan agreement that relationships with donors could deteriorate if there is a misunderstanding over terms and conditions. A standard loan agreement that could be completed by lenders would gather this important information and protect both the Charity and lender. In the absence of a formal agreement, as a minimum, all telephone conversations should be confirmed in writing with the lender and retained with other correspondence relating to the loan.

8.3 Conclusions

Given the wide range of income and expenditure there are reasonable controls over the systems capturing and reporting income and expenditure. We have made recommendations to strengthen controls.

8.4 Recommendations

- We recommend that there is formal, documented review of invoices prior to issuing. This relates to invoices raised in the Charity and in the trading subsidiary.
- We recommend that all loans are, at a minimum, confirmed in writing in order to minimise the risk to the Charity of its reputation being damaged due to any misunderstandings. Consideration should be given to having a proforma loan agreement that could be used. This would set out key aspects such as the repayment schedule and interest rate.

9 Forecasting

9.1 Scope of work

- Review of budget for 2014 and accompanying cashflow forecast.
- Review strategy document.
- Discuss and ascertain interaction between strategy document and activities.
- Business planning (eg Bristol expansion)

9.2 Work performed and results

Budgeting and forecasting

The budget is prepared annually with a reforecast at the six month point during the year. As the main expenditure item is payroll, this is based on organisational structure changes and new appointments approved by the Board in advance. Other key expenditure items are based on current levels and anticipated increases. Allowances are particularly difficult to budget for as historical data does not necessarily reflect the demands of the Charity in the future.

Cashflow forecasts are prepared for each year. As most donations are received in December and into the next calendar year, the first four months of the year tend to be cash positive. At this time the cashflow forecast reflects payment of ongoing operational costs as well as repayment of any liabilities that have built up towards the year end. At 31 December 2013 such liabilities included amounts due to HMRC, loans and trade creditors. Each month, £50,000 has been set aside in the cashflow forecast to meet prior year debts. Income, and the timing of receipt, is much more difficult to predict as only a small value of income is on a predetermined payment schedule. Where such a schedule is in arrears, for example some grant funding agreements, this puts extra pressure on cashflows.

Cashflow management is on a daily basis with bank balances emailed to the Accountability and Finance Director. A cashflow spreadsheet is maintained showing cashflow on a weekly basis, however, this is dependent on a number of members of staff updating for income and expenditure as appropriate. It does not appear that this has been the case as the brought forward cash balance on the statement we reviewed did not reconcile back to the bank statements. In addition, we understand that payments arising as a result of having to implement auto enrolment had not been factored into the cashflow, however, we understand that this has subsequently been included.

Strategy

Discussions were held with three Trustees and the Chief Executive to obtain an understanding of the strategy setting process. The Charity has a long term four stage strategy for its existence, culminating in bringing about changes in the system. Medium and short term strategies are based on where in the long term strategy the Charity sits.

Short term strategies are based on the annual "Can do" document produced by the senior management team and approved by the Board. This sets out the objectives for the year in terms of strengthening the organisation and increasing innovation. The short term strategy forms the basis of the fortnightly senior management team meetings -each Head of department is responsible for an element of the "Can do" document.

Business planning

Business planning decisions are proposed by the Senior Management Team and approved by the Trustees. Most decisions will form part of the annual strategy process, however, there may be other times when an opportunity arises outside of this. Such an example was the decision to replicate the

Charity's delivery model in Bristol. Whilst replication of the model in other cities is part of the longer term aims of the Charity, the opportunity in Bristol only came about due to funding being made available which enabled the Charity to expand.

We understand that following Trustee approval to proceed with the proposal for funding, a formal budget and proposal document was submitted as part of a public tendering process. Having succeeded in winning the tender, the key for the Charity is to ensure that the costs of the Bristol operations remain within budget and do not result in a drain on the cash resources.

9.3 Conclusions

It is clear from our work that the main financial risk to the organisation is cashflow. It appears that a significant amount of management and finance time is spent in assessing the cash position. From our review it is not possible to assess this time or how it could be better applied. Both strategy and business planning are appropriately managed, however, this must be considered in light of the serious cashflow position that the Charity often finds itself in. Without improving the cash position of the Charity it is not possible to build reserves and invest in new activities and locations.

9.4 Recommendations

We recommend that the cashflow spreadsheet is reviewed and responsibility for completing the document assigned to members of staff along with deadlines for completion. This will provide a more accurate short term assessment of the cash position.

This will provide information for the Trustees to identify, in advance, those periods where net cash outflows mean that meeting liabilities as they fall due is difficult. The Trustees should ensure arrangements are in place to meet liabilities, be it through additional borrowing, bearing in mind future cashflow implications, building up cash reserves, increased fundraising or restricting expenditure.

END OF REPORT

PKFLITTLEJOHN

Strong relationships, substantial partner involvement, honest answers and intelligent solutions from a dynamic team of accountants and advisers. We work with you to deliver the best for your business.

1 Westferry Circus
Canary Wharf
London E14 4HD
T +44 (0)20 7516 2200
F +44 (0)20 7516 2400
DX 42660 Isle of Dogs
www.pkf-littlejohn.com