

COMPLIANCE

Inquiry Report

Catz Club

Registered Charity Number 1112772



A statement of the results of an Inquiry into Catz Club (registered charity number 1112772).

Published on 17 December 2009.

The Charity

1. Catz Club ("the Charity") is a charitable company which was registered with the Commission on 20 January 2006. Its working name is Schoolfriendetc ("SFE"). Prior to registering as a charity, Catz Club, which was established in 2002, operated as a not-for-profit company.
2. The object of the Charity is to advance the education and provide for the recreation of children of school age by making facilities and services available to them during out of school hours and school holidays.
3. The Charity runs breakfast, after school and holiday clubs for children across the country. Its clubs use interactive numeracy and literacy computer software designed and developed by a private company called Schoolfriend.com ("SFC").
4. SFC was established in 2002 by the founders of Catz Club ("the Founders"). SFC provides at a fee, educational software to the Charity for use in all Catz Clubs. SFC, since its inception, has and continues to be the exclusive provider of computer software to the Charity.
5. Following Catz Club's conversion from a not-for-profit company to a charity the Founders were immediately employed by the Charity as Chief Executive and Chief Financial Officer. These were both paid positions. The Founders have worked voluntarily for the Charity since June 2007.
6. The Charity's accounts for the Financial Year End ("FYE") September 2008 show an income for the Charity of £2,359,615 and an expenditure of £2,697,369. The Charity's accounts show a budget deficit of £10,255,516. The accounts and annual return were received on 29 July 2009.

Source of Concern

7. In September 2007 the Commission received a complaint alleging conflicts of interest within the Charity. In particular it was alleged that because of the close relationships between the Charity, SFC and the Founders there was an unmanaged conflict of interest. It was also alleged that as a result of the Charity's use of SFC software, and the Founders' position within the Charity, that the Founders were in receipt of an unauthorised private benefit.
8. Further concerns were raised following the late submission on 4 October 2007 of the Charity's accounts for the FYE 2006 which showed a deficit of over £3 million. The accounts were not compliant with the Statement of Recommended Practice (SORP) for charity accounts.

9. The Commission had been considering issues relating to the financial management and administration of the Charity since September 2007 including concerns relating to internal financial controls and overdue submission of accounts.
10. As a separate issue, in August 2008 the Commission received a complaint from a Member of Parliament that the Charity had made a donation to the Labour Party (“the 2008 payment”). The Commission investigated the allegations and found that the Charity had breached charity law by directly supporting a political party. The Commission published its findings in a Regulatory Case Report on 5 September 2008. (See appendix A).
11. In October 2008 third sector media reported that Futurebuilders¹ had agreed to write off a portion of a £1.8 million loan and grant package made to the Charity in 2006 (see paragraph 32). The settlement of funding from Futurebuilders and the financial position of the Charity as reported in its FYE 2006 accounts raised further concerns about the financial position of the Charity.
12. On 17 December 2008 the Commission discovered as part of its financial analysis that a previous payment of £15,000 had been made by the Charity to the Labour Party in 2007 (“the 2007 payment”) and had not been previously disclosed to the Commission.

Commission inquiry

13. On 18 December 2008, the Commission escalated its existing regulatory compliance case to a statutory Inquiry. The Inquiry was conducted under s.8 of the Charities Act 1993.
14. The scope of the Inquiry was to investigate the trustees’ management and administration of the Charity, in particular its financial governance. This included an examination of the circumstances leading to the financial difficulties of the Charity as set out in the FYE 2006 accounts. The Commission also sought to determine what action, if any, needed to be taken to resolve these concerns.

Issues

15. The Inquiry examined the following issues:
 - (i) Payments to a political party; and
 - (ii) Governance of the Charity; including
 - (a) Financial management of the Charity;
 - (b) Arrangements between the Charity, SFC and the Founders; and
 - (c) Trustee decision-making and recording of key decisions

Timescale of inquiry

16. The Inquiry into Catz Club opened on 18 December 2008. The Commission’s substantive investigations were concluded on 16 September 2009. The Inquiry was closed with the publication of this report on 17 December 2009.

¹ Futurebuilders invests in third sector organisations delivering public services: <http://www.futurebuilders-england.org.uk/>

Findings

(i) Payments to a political party

17. In December 2008, as part of the Commission's ongoing investigation into the Charity, the 2007 payment was discovered which was not disclosed during the previous engagement with the Charity. The failure of the Charity to inform the Commission of the 2007 payment during the Regulatory Compliance Case into the 2008 payment raised further regulatory concerns regarding the Charity's governance and decision making by the trustees.
18. The Inquiry found that the 2007 payment of £15,000 comprised a £10,000 delegate fee to attend an event hosted by the Labour Party and a £5,000 donation to the Party. The event, attended by five representatives from the Charity, focused on the success of British sportsmen and women. The Charity explained that attending the event provided a forum to showcase its work and highlight the deficiencies in after-school care provision.
19. The trustees explained that they were unaware that part of the £15,000 payment to the Labour Party was characterised as a donation and were only aware that this was the case after the Commission raised this issue with them on 17 December 2008.
20. Although the trustees confirmed they were unaware of how the payment was characterised, the trustees should have informed the Commission of the 2007 payment to the Labour Party during the course of the Regulatory Compliance Case which investigated the 2008 payment even if they were unaware that part of the payment was treated as a donation.
21. The trustees informed the Inquiry that various discussions had taken place on a number of occasions regarding the Charity's strategy to engage with politicians in both central and local government using its experience to campaign for improvements in the provision of after-school care in the interests of its beneficiaries.
22. The Charity's funds given as donations to the Labour Party breached charity law requirements. The Commission has provided clear guidance (CC9) on the issue of campaigning and political activity by charities, which clearly states that "a charity must not give support or funding to a political party, nor to a candidate or politician".
23. The full £15,000 was subsequently refunded to the Charity by the Labour Party.
24. The Inquiry received assurances from the Chair of Trustees that no other payments to any political party or politician had been made by the Charity.
25. The trustees accept, notwithstanding paragraph 19, that the donation to the Labour Party should not have been made.

Conclusion – Payment to a political party

26. Donations to the Labour Party were made in breach of charity law.
27. The repayment of both donation and delegate fee (totalling £15,000) meant that the Charity recovered its money. The Commission therefore concluded that it was not proportionate to take further regulatory action on this issue.

(ii) Governance of the Charity

(a) Financial Management of the Charity

28. In relation to the financial management of the Charity, the Inquiry looked at the following areas:

- (a1) funding provided by Futurebuilders;
- (a2) SORP Compliance; and
- (a3) the Charity's financial records

(a1) Funding from Futurebuilders

29. The Inquiry was informed that following receipt of the grant and loan package ("the funding package") from Futurebuilders in 2005 (comprising of a £1.8 million loan and £200,000 grant), the Charity embarked on a path of rapid expansion in relation to the number of clubs that the Charity ran.
30. Within the first year, in accordance with the terms of the funding package, the Charity planned to increase the number of afterschool clubs by 738% - from 37 clubs to 273 clubs. By year five, the number was due to have increased by 3432%, to 1270 clubs.
31. The Chair explained that the view of the trustees at that time was that the Charity had identified the need for an expanded service in order to reach more beneficiaries. However, the expansion that had already taken place was not matched by an adequate number of children attending the clubs, particularly in the most deprived areas, where many clubs were unable to sustain themselves. Therefore, some of the clubs ran at a loss which over time resulted in a cumulative deficit of £10,255,516 as reflected in the FYE 2008 accounts.
32. As a result of the low-level uptake, a number of clubs remained dependent on central funding from the Charity for prolonged periods of time until, for some clubs, they were able to increase the number of children attending each club. The trustees explained that because of the pressure of funding on the Charity's central office and the repayment structure of the Futurebuilders loan, they considered and agreed to accept interest free loans from the Charity's Chair and to cease drawing down funds from Futurebuilders. In 2008 the Charity's Chair secured a settlement agreement on confidential terms with Futurebuilders agreeing that some of the funds could be written-off and the balance personally paid for by the Chair.
33. The trustees of the Charity informed the Inquiry that securing funding from Futurebuilders was integral to their long term expansion plans for the Charity. During the Inquiry the trustees explained that the motivation for converting to and registering as a Charity was primarily due to a condition from Futurebuilders to do so in order to secure funding. The Inquiry was not able to verify this account but note from records provided by the Charity and Futurebuilders, that Futurebuilders expressed interest in the registration process.
34. The trustees recognise in hindsight that the expansion programme for the Charity was overly ambitious but still felt it was the best option available to them at the time which would have allowed an expansion of the after-school clubs run by the Charity.

35. The Inquiry accepted the explanation, as set out in paragraph 32 above, and evidence provided by the trustees as to how the Charity got into financial difficulties in the first place. The Inquiry noted that the auditors for the Charity's FYE 2007 accounts were satisfied, that although there may have been doubt cast upon the Charity's ability to continue, it would receive financial support sufficient for its projected working capital needs from the Chair². The Inquiry is of the view that the Charity's growth plans were overly ambitious and found that its ongoing operations were only sustainable with the financial support of the Chair. The Inquiry also noted that the trustees entered into the loan agreement with Futurebuilders with full knowledge of the terms of the funding package, and the Commission is critical of the trustees in this respect.

(a2) SORP Compliance

36. The Inquiry provided the trustees with advice and guidance relating to the financial statements of the Charity both generally and specifically in relation to the FYE 2007 accounts. These were not SORP compliant in a number of ways, in particular the classification of income and expenditure and the omission of disclosure of details of any trustee remuneration in the year or details of related party transactions. Information contained in the Charity's Annual Return presented a misleading picture of the Charity's activities for the year. It indicated that all of the £4.13 million expenditure for the year was spent on governance costs and the costs of generating income, with nothing being spent on charitable activities.

37. The trustees confirmed that the Annual Return was not correct and took action to remedy this by resubmitting a corrected version.

38. The latest accounts submitted by the Charity are on the whole SORP compliant. The Inquiry provided further advice to the trustees on related party transaction notes and the breakdown of expenditure. It also reminded the trustees that there were a number of other issues which were previously raised with them which did not appear to have been actioned in the latest accounts.

(a3) The Charity's financial records

39. The Inquiry conducted a books and records inspection at the Charity's premises and reviewed the financial records of the Charity. No material irregularities were identified during this inspection.

Conclusion – Financial Management of the Charity

40. The Inquiry accepted the explanation offered by the trustees regarding the Charity's financial difficulties, namely that this was largely attributable to the poor take up of clubs and the Charity's failure to comply with the terms of the funding package from Futurebuilders. The Inquiry is of the view that the Charity's growth plans were overly ambitious and found that its operations were only sustainable with the financial support of the Chair. The Inquiry also found that the trustees had entered into this agreement with full knowledge of the terms of this funding package and the Commission is critical of them in this respect.

² Page 4 of the Charity's FYE 2007 accounts – available on the Commission's website www.charitycommission.gov.uk. In the FYE 2007 accounts the net loss for the year was £5,656,864.

(b) Arrangements between the Charity, SFC and the Founders

41. In relation to the arrangements between the Charity, SFC and the Founders the Inquiry looked at the following areas:

(b1) the continued use of SFC software; and

(b2) the continued role of the Founders in the Charity and any resulting conflicts of interest or private benefit.

(b1) The continued use of SFC software

42. The trustees advised the Inquiry that the Charity's continued use of SFC software was regularly reviewed and that they had not identified alternative software to that provided by SFC. The Charity continues to use the SFC software.

43. The exclusive use by the Charity of the SFC software was agreed in April 2003 prior to the conversion of Catz Club to a Charity in 2006. Upon conversion the trustees did not formally re-sign or ratify an agreement with SFC. The Inquiry considered that had the trustees done this, they would have been able to demonstrate that they had considered the agreement with SFC as being in the best interests of the Charity. In the absence of this, the trustees were unable to do so although remain of the view that it is in the best interests of the Charity.

(b2) The continued role of the Founders in the Charity and any resulting conflicts of interest or private benefit

44. Upon conversion to a Charity in 2006, the Founders of Catz Club stepped down as directors and were immediately appointed by the trustees as Chief Executive Officer and Chief Finance Officer respectively. Over time the role of the Founders has been scaled back, firstly to part-time employees and finally since June 2007 as voluntary staff.

45. The Inquiry considered that the Founders, given their role in the Charity and that they established SFC, were conflicted and in a position to benefit personally from agreements between SFC and the Charity. This would only be acceptable if it was a legitimately incidental benefit³. The trustees accepted that a conflict existed but did not consider that this posed a problem for the Charity, focussing instead on the valued contribution of the Founders.

46. This issue was compounded because of the similarities in the working name of the Charity (schoolfriendetc) and the company SFC (schoolfriend.com). The Inquiry was of the view that this could have caused confusion for members of the public who may have considered that the two separate organisations were in fact the same.

47. Information supplied by the Charity during the course of the Inquiry indicated that the Founders spent considerable time showcasing and promoting the work of the Charity. The trustees did not consider that in doing this, the Founders were increasing streams of revenue for their own non-charitable products.

³ Private Benefit – refers to any benefit or benefits a person or organisation receives other than as a beneficiary of a charity. Charities can provide private benefits to people other than their beneficiaries so long as those as those benefits are incidental. Private benefits will be incidental if it can be shown that they directly contribute towards achieving the charity's aims and/or are a necessary result or by product of carrying out those aims.

In general, a private benefit is a necessary result, or by-product, of carrying out a charity's aims if:

- (i) it follows from some action that is taken, and is only taken, with the intention of, furthering the charity's aims; and
- (ii) the amount of private benefit is reasonable in the circumstances.

Conclusions – Arrangements between the Charity, SFC and the Founders

48. The trustees did not recognise or adequately manage conflicts of interest that arose as a result of the continued role of the Founders in the Charity.
49. By virtue of the arrangements the charity had in place with the Founders and SFC, it is difficult to see how the private benefits received by the Founders, when viewed in totality, could be regarded as legitimately incidental. However, for the reasons set out in paragraph 60, on this occasion and in all the circumstances the Commission did not consider that restitution was an appropriate course of action.

(c) Trustee decision-making and recording of key decisions

50. The Inquiry noted that the trustees failed to keep adequate records of their decision-making. The trustees were consistent in their individual accounts of how and why decisions were reached, however the Inquiry still had difficulty in establishing what had happened at key events in the Charity's history, including the decision of the trustees to continue to use SFC software and transactions with the Founders of the Charity.
51. The Inquiry accepted the account provided by the trustees as to how the Charity came into financial difficulties as a result of its expansion programme, and that in order to continue operating the Charity required additional funding.
52. Informal interest-free loans from the Chair of trustees to the Charity were provided from 2006 onwards. The 2008 accounts show that the Charity has outstanding loans to the Chair totalling over £13 million. The Inquiry accepted the trustees' verbal account of how decisions to accept loans were made, but advised that these agreements should have been formalised in writing to protect both the Charity and the Chair.

Conclusions – Arrangements between the Charity, SFC and the Founders

53. The trustees failed to keep adequate records of their decision making. This unnecessarily exposed the trustees' decisions to risk of challenge. In view of the nature of the conflicts that existed in relation to the Charity's contractual arrangements with the Founders, and the significant sums involved, the Commission is critical of the trustees for this.

Conduct of inquiry

54. The Inquiry examined the governance and financial management of the Charity. This included corresponding with the trustees and key staff and carrying out a visit to the Charity's premises to conduct a books and records inspection.

55. The Inquiry conducted a books and records inspection and a detailed analysis of the Charity's financial accounts. It was evident from this analysis that detailed paper and electronic records were maintained.
56. The trustees co-operated with request for information by the Inquiry and provided these in a timely fashion
57. During the course of the Inquiry the Commission provided the trustees with regulatory advice and guidance regarding their duties and responsibilities and on good practice to assist them in the future.

Regulatory action taken

58. Both prior and during the course of the Inquiry the Commission exercised its powers under s.9 of the Act to obtain copies of documents relating to the Charity.
59. The Inquiry concluded that the trustees had a potential liability to account for the monies that had been paid to the Charity's Founders as a result of the various arrangements between the Charity and them – including the continuation of an agreement between the Charity and SFC to exclusively provide software to the Charity, and the remuneration of the Founders.
60. However, having considered the particular factors and circumstances of the case, the Inquiry did not think it was interests of charity to pursue the issue of recovering money from the trustees for funds which flowed to the Founders. There were various factors that contributed to this decision, including -
 - (a) there was no evidence to suggest that the trustees had been dishonest in setting up the arrangements of the Charity. On the contrary, because of the strong and consistent evidence put forward by all of the trustees, there was no evidence to suggest that the trustees would have acted differently even if they had managed the conflicts of interest that had arisen;
 - (b) similarly, the evidence provided by the trustees indicated that they would have taken the same decisions in respect of the employment of the original Founders of Catz Club;
 - (c) the Founders and the trustees made personal positive contributions for the benefit of the Charity. In particular the Chair had provided significant financial support to the Charity without which it could not have continued to operate;
 - (d) there is no evidence that the remuneration of the Founders in their paid position or the fees charged by SFC were unreasonably high or were not in the best interests of the Charity;
 - (e) the terms under which the Charity purchased the software were carefully scrutinised;
 - (f) the trustees were satisfied that this transaction was treated as an arms' length transaction and that the price paid was fair and reasonable;
 - (g) the marketplace had been examined for other available software but there was no other type which met the Charity's needs as well as SFC; and
 - (h) SFC has not charged the Charity for use of its software in the various clubs run by the Charity since 2006.

Impact of Commission intervention

61. The Commission has provided the trustees with regulatory advice and guidance to assist them to discharge their duties.
62. As a result of its investigation the Commission has been able to provide an explanation of the factors that contributed to the Charity's financial difficulties.
63. As a result of the Commission's intervention, the Charity has been reimbursed £15,000⁴ by the Labour Party for the payment made in 2007 which comprised £10,000 delegate fee and £5,000 donation. It was the Commission's view that only the £5,000 donation was a misapplication of funds.

Resources applied

64. The Commission adopted a multi-disciplinary team working approach on this case both before and during the Inquiry which involved investigators, lawyers and an accountant.

Actions required of the trustees

65. The trustees stated during the course of the Inquiry that it had been their intention prior to the Commission's engagement with it, to carry on the activities of Catz Club as a Community Interest Company (CIC), which is a non-charitable entity. The trustees have provided the Inquiry with documentary evidence to support this, and wish to continue with this course of action. The trustees have given the Commission an assurance that the Charity will be wound down on a solvent basis. The Commission has no objection at this time to their proposals, and are continuing to liaise with the trustees to ensure that they continue to properly discharge their duties towards the Charity and its assets. In instances where a charity converts to a CIC and the charity no longer exists, any assets owned by it must continue to be applied for charitable purposes and the CIC acts as the trustee of these assets, which the Commission will monitor accordingly.

Issues for the wider sector

66. Those registering a charity should take time to consider the full implications of charity registration, the effect on its purposes, its impact on the operations of the organisation and the duties and responsibilities this gives rise to.
67. Trustees must ensure the charity complies with charity law and the requirements of the Commission as regulator. Further guidance on about the obligations and responsibilities of trustees can be found in '*The Essential Trustee: What you need to know (CC3)*' on our website.

⁴ The Commission's previous engagement with the Charity in September 2008 resulted in a £15,000 payment from the Labour Party to the Charity.

68. It is a fundamental principle that charities must remain independent from party politics and cannot give support to a political party, politician or political candidate. This is the case both as a matter of purpose and activity. This is because political parties have a full spectrum of policies, which may change. Support to a political party encompasses support of all their policies, many of which will be outside of a charity's objectives. Also a charity's purposes must, as a matter of law, be for the public benefit. A charity cannot demonstrate political support to be for the public benefit, as it is not possible for the courts to judge the public benefit of one policy over another.
69. Trustees must act collectively when taking decisions that concern the charity. They are personally responsible for the decisions they make. Trustee decisions and the discussions preceding them should be clearly recorded in minutes. For further information please refer to *Charities and Meetings* (CC48) which can be found on our website.
70. CICs are limited companies designed for people who want to conduct a business or other activity for community benefit and not purely for private advantage - more information on CICs can be found at <http://www.cicregulator.gov.uk/>. The Companies (Audit, Investigations and Community Enterprise) Act 2004 introduced this corporate structure and contains provisions for enabling charitable companies to re-register as a CIC and vice versa. A charitable company seeking to convert to a CIC must obtain the written consent of the Commission before the conversion can take place. Before providing consent the Commission considers the reasons provided by the charitable company for the change in its status. Upon conversion to a CIC any assets that were owned by the charitable company are impressed with charitable trust - an "asset lock" - which means that these can only be used for charitable purposes.
71. A significant number of charities depend upon grant and/or loan funding for some or all of their income. Before accepting funding, trustees must satisfy themselves that to do so is in the best interests of the Charity. This should include consideration of the terms and conditions attached to the funding and whether these are realistically achievable. Where funding requires rapid expansion of a charity's activities the trustees need to consider whether the charity's infrastructure is able to absorb any additional work and costs that follow. A failure to successfully manage a charity's expansion may result in unsustainable rapid growth which puts the long term viability of the charity at risk.

**You can obtain large-print versions
of this publication from the Charity
Commission on 0845 300 0218**

Charity Commission

Telephone: 0845 300 0218

Typetalk: 0845 300 0219

**By post: Charity Commission Direct
PO Box 1227
Liverpool
L69 3UG**

Website: www.charitycommission.gov.uk