

Chariot House seminars November 2017

Speaker's notes: Sarah Chiappini

Charity Governance Code – publication of 3rd edition

Background

In addition to the numerous Charity Commission publications which set out both legal requirements and best practice recommendations in relation to various aspects of charity governance, the charity sector has had its own code of governance since 2005. Following a public consultation by a code steering group (comprising representatives from various charity sector bodies), the third edition of the Code was published on 12 July 2017:-

- <https://www.charitygovernancecode.org/en>

The revised Code builds on earlier editions but now places greater emphasis on values, accountability, transparency, probity, maintaining control, leadership and the diversity of opinions and skills.

The importance of good governance

Following various high profile matters involving charities reported in the press over the last couple of years, including the fundraising controversies that unfolded during the summer of 2015, the collapse of Kids Company and Age UK's arrangements with E.ON, "good governance" is currently the dominant theme in the charity sector.

Indeed, the Charity Commission has stated that in its view many of the problems that unfolded in 2015 and 2016 could have been avoided by "good governance"

What is "good governance"?

There is no legal or formal definition of "good governance" and the Code does not attempt to define it either. However, in broad terms it is about charities having appropriate systems and processes in place in relation to their legal obligations, accountability, overall direction and effectiveness.

In my view, the quote below sums up in a nutshell the practical importance of good governance:

"The golden rule of charity governance is that charity is delivered at the front line but it begins in the back office."¹

Status of the Code

The introduction to the Code provides that:

"The Code is not a legal or regulatory requirement. It draws upon, but is fundamentally different to, the Charity Commission's guidance. Instead, the Code sets the principles and recommended practice for good governance and is deliberately aspirational."

¹ Asheem Singh, former interim chief executive of ACEVO in response to the Code consultation

Having said that, the Code encourages charities to meet the principles and outcomes of the Code by either *applying* the recommended practice or *explaining* what they have done instead or why they have not applied it.

Non-compliance with the Code: the Charity Commission's stance

When the draft Code was published the Charity Commission acknowledged that it would not “own” the Code, but confirmed that it would endorse and promote it as a standard of good governance practice². This is echoed in the Commission's blog on the final Code:

“The bottom line is, good governance is no longer an optional extra...The Charity Governance Code represents a standard of good governance practice to which all charities should aspire. We encourage all charities to read, follow and apply it proportionate to their circumstances.”

However, the above blog did not provide any further clarification, as requested during the consultation process, as to the possible consequences if charities do not apply the Code (so far as is relevant). It is presumed, therefore, that consistent with the Commission's apparent conflation of what charities **MUST** do and what they **SHOULD** do³, its stance remains as indicated in its response to the draft Code:

“We will consider further how we can take account of charities' consideration and application of the Code in our regulatory interactions with them and in the requirements and expectations for reporting.”

It is hoped that greater clarity will emerge on this issue in due course but until such time, it appears that the reality may well be that *“Charities and their trustees will ignore the Code at their peril.”*

It is also worth noting that in its report on charities entitled *Stronger charities for a stronger society* (published in March 2017), the House of Lords Select Committee confirmed that it welcomed the Charity Commission's decision to use the revised Governance Code as a benchmark for good governance. (See the link to the Filanthropia briefing note for a summary of the contents of this report:

http://filanthropia.co.uk/House_of_Lords_report_on_charities_March_2017.pdf)

Two Codes: one for larger and one for smaller charities

Two codes have been produced: one for larger charities with a typical annual income over £1m which takes it over the audit threshold and one for smaller charities whose income is below the audit threshold.

The two versions only differ slightly in relation to some of the recommended practice. (In both, the Foundation Principle and the seven governance principles – see below- remain the same). It is not immediately apparent at a glance what the differences are but, in general, the version for larger charities assumes that the charities will have staff (including a CEO) and will be more complex in terms of structure and activities.

Larger charities are expected to publish more information in their annual report and/or elsewhere (ie their website) in relation to, for example, the charity's approach to risk; how trustees' performance is evaluated; and the process of setting remuneration of senior staff.

² In line with this, the Commission has withdrawn its publication CC10 *The Hallmarks of an Effective Charity*.

³ It appears that the failure by charities and their trustees to follow the “best practice” recommendations in CC3 and other guidance published by the Charity Commission may be taken as evidence by the Commission of breach of trust or misconduct or mismanagement, thus allowing the Commission to invoke its regulatory and protective powers.

Contents of the Code

Foundation principle

The Code begins with the underlying “Foundation Principle” that all trustees:

- are committed to their charity’s cause and have joined the board because they want to help the charity deliver its purposes most effectively for public benefit;
- recognise that meeting their charity’s stated public benefit is an ongoing requirement (note that it is in fact a legal requirement that charities operate for the public benefit);
- understand their roles and legal responsibilities and, in particular, they have read and understand:-
 - o the Charity Commission’s guidance CC3 *The Essential Trustee, what you need to know, what you need to do* <https://www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3>⁴; and
 - o their charity’s governing document (note that compliance with the governing document is a legal requirement); and
- are committed to good governance and want to continue to their charity’s continued improvement.

Seven governance principles

Following the Foundation Principle there seven specific governance principles. These fall under the headings of:-

1. Organisational purpose: the board is clear about the charity’s aims and ensures that these are being delivered effectively;
2. Leadership: every charity is led by an effective board that provides strategic leadership in line with the charity’s aims and values;
3. Integrity: the board acts with integrity, adopting values and creating a culture which helps achieve the organisation’s charitable purposes. The board is aware of the public’s confidence and trust in charities, and trustees undertake their duties accordingly;

⁴ CC3 sets out the six key legal duties and responsibilities of charity trustees together with best practice recommendations. The six key legal duties and responsibilities outlined in CC3 are:

- 1. Ensure that your charity is carrying out its purposes for the public benefit
- 2. Comply with your charity’s governing document and the law
- 3. Act in your charity’s best interests
- 4. Manage your charity’s resources responsibly
- 5. Act with reasonable care and skill (also known as the duty of care)
- 6. Ensure your charity is accountable.

I have produced an introductory guidance on such legal duties and responsibilities (based on CC3). If you would like a copy please contact Sarah Chiappini: sarah@filanthropia.co.uk

4. Decision-making, risk and control: the board makes sure that its decision-making processes are informed, rigorous and timely and that effective delegation, control and risk assessment and management systems are set up and monitored;
5. Board effectiveness: the board works as an effective team, using the appropriate balance of skills, experience, backgrounds and knowledge to make informed decisions;
6. Diversity: the board's approach to diversity supports its effectiveness, leadership and decision-making;
7. Openness and accountability: the board leads the organisation in being transparent and accountable. The charity is open in its work unless there is good reason not to be.

The Code sets out under each of the seven principles the rationale for the particular principle; an expectation of key outcomes; and various recommended practice.

Some observations on the Code

Lack of clarity regarding what trustees **MUST** do and what they **SHOULD** do

The draft Code highlighted in a small section at the end of each principle the relevant underlying legal and regulatory context. During the consultation process it was suggested, by the Charity Commission amongst others, that there was scope in the Code for greater clarity regarding, and cross referencing to, trustees' legal duties and responsibilities. However, despite this, rather surprisingly the sections highlighting the legal and regulatory context have been removed altogether from the final Code.

It should be noted, however, that there are some aspects in the "Recommended Practice" sections under the various principles that are legal requirements rather recommended best practice. For example:-

- principle 2 (leadership) – includes the recommended practice that the trustee board takes collective responsibility for its decisions: however, it is a matter of law (not best practice) that trustees are ultimately and collectively responsible for the control and management of the administration of their charity;
- principle 3 (integrity) – includes the recommended practice that:-
 - o trustees maintain the charity's reputation and deal appropriately with conflicts of interest and loyalty: however, trustees have a legal duty to act in the best interests of their charity and this duty is relevant in these two scenarios; and
 - o the board ensures that the charity follows the law: however, compliance with the law is not a best practice issue!

In my view, the lack of distinction/clarity in the final Code between what charities **MUST** do as a matter of law and what they **SHOULD** do as a matter of best practice, could lead to trustees failing to comply with their legal duties and responsibilities.

What the final Code does not contain

Tick box format

In its response to the consultation, the Charity Law Association recommended that the Code is produced in a “tick-box” format which would make it easier for trustees to record their charity’s engagement with the Code’s governance principles. However, this suggestion was not carried over to the final version.

Code of Fundraising Practice

In my view, it would have been helpful if there was at least a brief reference to the Fundraising Regulator and the Code of Fundraising Practice (“Fundraising Code”). It should be noted that the recently revised Fundraising Code provides that trustees have regard to the [Governance] Code (together with the Charity Commission’s core guidance CC3 and its fundraising guidance CC20) in overseeing the fundraising practices of their charity.

Justification regarding re-appointment where a trustee has served for nine years

The Code recommends that where a trustee has served for nine years, any further re-appointment should be subject to a particularly rigorous review; takes into account the need for progressive refreshing of the board; and is explained in the trustees’ annual report.

In theory this is sound, but in practice with the bar being set ever higher for charities and their trustees in terms of what is expected of them, trustee recruitment (and indeed retention) may become an issue. Consequently, long serving trustees could well become increasingly valuable to the stability and effectiveness of the trustee board.

What next?

I recommend that trustees note the following:-

1. identify which Code is relevant to their charity – ie is your charity a larger or smaller charity?
2. read the relevant Code and note which elements (in addition to the Foundation Principle) are or might be relevant to their charity;
3. prepare an action plan: prioritise accordingly;
4. *“apply or explain”*: note that the Code encourages charities to meet the principles and outcomes of the Code by either *applying* the recommended practice or *explaining* what they have done instead or why they have not applied it. Carefully minute decisions made in this regard;
5. charities that adopt the Code are encouraged in the Code to publish a brief statement in their annual report explaining their use of the Code;
6. consider whether it would be appropriate to establish a governance committee to deal with the above; and
7. take expert advice as considered necessary/appropriate.

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This note provides a general summary only and it does not constitute legal advice. It is recommended that specific advice is sought in relation to the particular facts of a given situation. If you have any queries regarding any aspect of this note or you would like us to assist you with a governance review and/or assist with the preparation of any relevant documentation please do not hesitate to contact Sarah Chiappini.