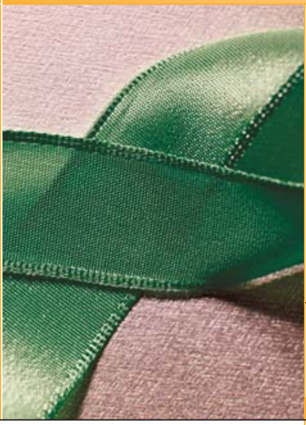
Spring 2009

ChantreyVellacottDFK



Charity Briefing

Keeping you up to date with events in your sector.

Welcome

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Welcome to this Spring edition of Charity Briefing. Regular readers will note that we have slightly re-vamped the format and we hope that you like our new style. In line with many organisations we have become more aware of our environmental 'foot-print' and of the consequences of our actions. With this in mind we have consciously contracted the production and distribution of our Briefing with an organisation that is set up to be carbon neutral by the planting of trees in the UK to off-set the carbon produced.

Included in this edition we have the third and final instalment on fraud and details of the fraud survey jointly carried out by ourselves and the Fraud Advisory Panel. The resulting report gives a fascinating insight into the attitudes and perceptions to fraud within the Charity Sector.

We also detail further provisions of the Charities Act 2006 that have been brought into force under the fifth Commencement Order and a summary of the matters arising from the recent Budget and their likely implications for charities and not-for-profit organisations.

If you would like to discuss any matters arising from the following articles please contact myself or the other members of our Charity Group. I look forward to seeing you at one of our free upcoming charity seminars, details of which are available on our website.

Fraud - What does it really mean for charities? Part 3

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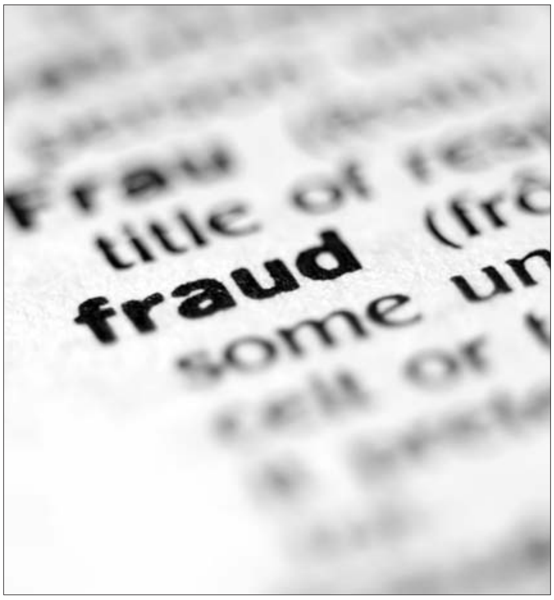
To conclude our series on 'Fraud – what does it really mean for charities?' we are proud to announce that the charity fraud survey carried out jointly by the Fraud Advisory Panel and ourselves has been published.

Amongst the findings, the survey highlighted that many charities are ill-prepared to deal with fraud. The research, conducted amongst charities with an income of £10,000 or more and released on 24 February 2009, revealed that 60% of charities in England and Wales had no significant anti-fraud policies and procedures in place. This rose to almost three-quarters amongst the smaller charities.



The survey, however, identified that charities are less likely to be hit by fraud than the corporate sector – but some fraudsters are taking advantage of charities' goodwill and trust. Dr Stephen Hill, Head of our Fraud and Forensics Group, went through the findings with an audience of charities at Chartered Accountants' Hall in the City.

The report 'Breach of Trust', which summarises the key findings of this research, can be downloaded from our website at www.cvdfk.com/news. The full report, entitled 'Fraud in the Charitable Sector', which includes graphical presentations of detailed findings, is also available to download. The survey was acknowledged by the regulators, with Charity Commission

Chief Executive, Andrew Hind welcoming the findings, stating, "Clearly there is more that charities can and should do to be fraud-aware."

The challenge for the charity sector is to understand the lessons learnt from the findings and by other types of organisation, particularly in relation to preventative controls and procedures as well as improved communication and collaboration between charities, representative bodies and regulators. To assist in this area, we have developed a Fraud 'Healthcheck' to determine if fraud is or could potentially become a problem in your organisation. More information on this service can be obtained from our website at **www.cvdfk.com/charities**

We believe that the work undertaken by the Fraud Advisory Panel and ourselves will help in our fight against charity fraud, and challenge us all in our roles to communicate more cohesively and adopt best practice. Even if you haven't experienced a fraud, we hope the findings from this survey will help you become more aware of how fraud can affect your organisation. Crucially, we hope charities will better understand how best to protect themselves and those who rely upon them.

For further information or to obtain a copy of the report, please contact Dr Stephen Hill at shill@cvdfk.com or call 020 7509 9000 or visit our website at **www.cvdfk.com/news** Stephen is a trustee director of the Fraud Advisory Panel and Head of the Fraud & Forensic Group at Chantrey Vellacott DFK LLP.

Action Points

1. Who is responsible for your fraud issues?
2. Do you have a fraud response plan or policy?
3. Are your staff and volunteers aware of the risks of fraud?

Charities and the present economic climate

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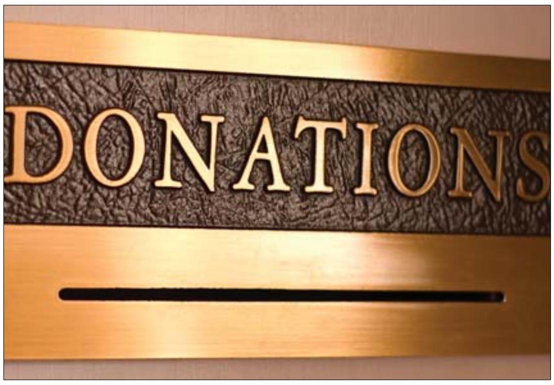
Charities are in many ways no different from their commercial cousins, and the present economic downturn is already starting to have an impact on the 'not-for-profit' sector. However, despite the downturn there are some positives to be seen at the moment:

- Charity shops are seeing an increase in customers buying second-hand clothes and furniture.
- Those charities currently recruiting staff are starting to find they have a larger pool of people to choose from, following redundancies in the commercial sector.
- Inner city projects are seeing an increased call for their services (if one considers this to be positive).

Unfortunately, the downside is far more widespread:

- Donations are starting to slow down (with the Children in Need and Comic Relief appeals honourable exceptions). These include donations of stock to the charity shops, who may find themselves with more customers but nothing to sell them! Charities will have to be pro-active in approaching key donors to confirm future income streams as soon as possible.
- There are also more low-cost clothing outlets this time around than there were in the last recession. This may mean that charity shop throughput is less than during the last recession overall.



- Those charities being funded by substantial investment portfolios are seeing the value of those investments reduced significantly, and cuts in dividend payments by many quoted companies are likely to reduce their income. The fall in value may be less of a concern in the short-term than the fall in income. Likewise, those charities holding substantial cash deposits will see a reduction in earnings due to significantly lower interest rates.
- While the stock market is at its present level, the reduction in the value of investments generally is also likely to reduce the value of some of the legacies charities were hoping to receive in the foreseeable future.
- Those who have property portfolios may find their tenants in trouble, and therefore suffer a potential loss of rental income. Where properties are held as investments, this rental loss will combine with a fall in property values.

It is not an easy time for anyone in the sector – but with sensible planning and prompt action, your charity will still be here long after the recession is over!

…with some imagination, there are positive steps that can be considered.

- We are aware of at least one charity whose bank loan has come to the end of its term, and a renewal on similar terms is proving difficult to negotiate.
- Regular grants available from the public sector are proving harder to maintain, let alone get increases for.
- Finally, staff salary increases are proving difficult to justify when they could be seen to be at the expense of the charity's activities; and yet those same staff still have to pay their bills.

So what is to be done?

Well, not surprisingly, the way forward for charities is primarily no different from that for other commercial enterprises:

- Budgets need to be reviewed actively and continuously. The knee-jerk reaction just to cut a swathe through costs may not necessarily be the right one. The major costs (which for many must be payroll) need to be kept in check. However, redundancies and staff loss cost money in the short term, as does losing the knowledge base of those staff. Cutting down on marketing and fundraising costs may well cause income to reduce further.
- Fundraising activities therefore need to be rethought, and in some cases re-engineered to maximise their effectiveness.
- Capital projects may have to be put on hold for now (but not necessarily all projects).
- Trustees must sit down with their investment advisors and review investment criteria.
- Charities must consider both their level of reserves and their reserves policies.
- At the same time, the question needs to be asked as to whether the charity has a future. Has it reached the end of its useful life? Does it indeed have a future?

These may seem very obvious points, but nevertheless these questions have to be asked, and discussions held and documented, to ensure that trustees can show, if ever challenged, that they have acted responsibly.

Nevertheless, with some imagination, there are positive steps that can be considered:

- Those of you coming to the end of your property leases may find your landlord more amenable to a renegotiation of the terms to slightly more favourable ones, rather than having a vacant property. This may save not only a little on rental, but also the major cost of removal to a new site. This of course will depend on the location of the property, the number of vacant properties around, and your abilities as a negotiator!
- Can a capital project still be a positive step? Perhaps this might be the time to purchase a property for the use of the charity instead of paying rent. Consider the trade-off between the saving of rental expenditure and the loss of investment income on reduced investments. Clearly this is not a step to be taken lightly, but nevertheless for the right charity with the right property at the right time, it could be a possible step.
- One further course of action you may consider would be some sort of joint venture or even merger with another charity carrying out similar tasks in a similar geographic area to a similar client base. There may be some loss of independence to you, but by sharing overheads or staff, you can continue to fulfil the charity's objectives and at the same time cope with the pressures of reduced funding.

It is not an easy time for anyone in the sector – but with sensible planning and prompt action, your charity will still be here long after the recession is over!

Action Points

1. Revisit budgets and cash flows
2. Talk to your major funders and get early warning of their intentions
3. Consider collaborative work opportunities

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Website Monitor

64% of the largest charities are feeling the impact of the downturn and are concerned that future work will be affected.

New figures released on 17 March 2009 by the Charity Commission reveal the deepening impact of the recession on charities in England and Wales, with more than half reporting they have been affected. In September 2008, 38% of charities surveyed by the charity regulator said they had been hit by the credit crunch; this figure has now risen to 52%, following one of the largest representative surveys to date. The majority (64%) of charities with an annual income of over £1m say they are concerned that their services or funding might be greatly affected.

The Charity Commission's latest Economic Survey of Charities illustrates the deepening impact of the recession on charities. The report's key findings are:

- 52% of the charities surveyed say they have been affected by the financial downturn; of these, 58% have experienced a decrease in income
- 32% of charities say they have taken steps to combat the effects of the downturn
- 64% of charities with an annual income of over £1m are concerned that the downturn is going to affect future work
- Just 3% of charities say they have considered collaborating with another charity, and 3% have considered merging. The new research reveals some of the measures being taken by charities to combat the effects of the downturn:
- 32% have taken steps to limit the impact of the current financial climate, from reducing costs (14%) to increasing fundraising efforts (11%) or drawing on reserves (6%).
- Some charities have had to put other measures in place, such as cutting or holding off new services (5%) or reducing numbers of staff (2%).

The research also revealed that charities' experience of the effects of the downturn varies depending on their size:

- Charities with an annual income of £1m or more were less likely than other charities to have experienced a reduction in income – 46% had done so. For charities with an income of between £100,000 and £999,000 the figure was 65%. For the smallest charities (those with an income of under £10,000) it was 60%.
- Only 23% of the smallest charities had put measures in place to combat the effects of the downturn, compared with 65% of the largest charities (those with an income of £1m or more).
- 14% of the largest charities had drawn on reserve funds; this figure dropped to 6% across all the charities surveyed.

The Financial Services Authority (FSA) has issued a consultation on the reform of the Financial Services Compensation Scheme (FSCS)

The FSA is consulting on possible changes to the FSCS with a view to speeding up the compensation process and improving awareness of the scheme among consumers (including charities).

The consultation document can be viewed at www.fsa.gov.uk/pubs/cp/cp09_03.pdf

The FSCS covers business conducted by firms (e.g. banks or building societies) authorised by the FSA, and can pay compensation to consumers if an authorised firm is unable, or likely to be unable, to pay claims against it. The rules for the FSCS are made by the FSA and they set out which types of claims can be considered. The compensation limit for deposits is currently £50,000.

The information provided by the FSCS about the Scheme does not specifically mention charities. However, it appears that charities are covered by the Scheme to the same extent as other organisations and individuals.

The FSA Handbook of rules and guidance sets out which claims will not be eligible for compensation. Many charities should be eligible to claim compensation but there appear to be a number of important exceptions. In the Charity Commission's view, the exceptions that are most likely to include charities are:

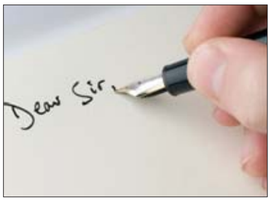
- a body corporate (which includes a company, industrial and provident society, Royal Charter body, and statutory corporation) which has two or more of the following:
  - more than £6.5m turnover
  - more than £3.26m balance sheet total
  - more than 50 employees
- an unincorporated association which has assets of more than £1.4m
- collective investment funds (these would include common investment funds).

The Charity Commission guidance on how the FSA regulations affect compensation payments to charities can be seen at www.charitycommission.gov.uk/news/fincomp.asp

Watchdog reports on Children's Welfare Foundation as complaints continue.

The Charity Commission has just published its inquiry into the charity, Children's Welfare Foundation, amid continuing complaints about improper fundraising in its name.

The Commission opened its investigation into the charity in January 2008, after receiving numerous complaints from the public and local Trading Standards departments into unauthorised and unlicensed clothing collections undertaken on behalf of the charity.



The inquiry found no evidence of any charitable expenditure by the charity. There were also unlicensed collections, unauthorised trustee payments, losses made by a trading subsidiary, mismanagement of the charity's affairs by the trustees, and a sustained lack of co-operation in providing information to the Commission.

The Children's Welfare Foundation was removed from the Register of Charities on 24 October 2008, and its remaining assets transferred to another charity.

Some organisations provide a 'registration number' which is a company registration number, rather than a charity registration number. Households can check if an organisation undertaking clothing collections is a registered charity via the Charity Commission's online Register of Charities at www.charitycommission.gov.uk

The inquiry report is available from the Commission's website under 'Inquiry reports and regulatory case reports'.

Budget Update

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Despite the fact that the Chancellor made no specific reference to the Charity Sector in the recent budget there are a number of measures announced in the small print of the Budget report which are of importance to the sector.

Gift Aid: Higher – rate donors

Para 5.83 of the Budget report makes reference to the above as follows:

5.83 The Government continues to explore ideas to improve Gift Aid, and has commissioned research into the effect of redirecting higher-rate relief from donors to charities.

There has always been a question as to whether individual donors chose to donate to charities because of the availability of higher rate tax relief. If all the tax relief were in future to go to the charity this would be of significant benefit to the sector and this is clearly an area that the sector might wish to lobby Government.

Clearly since we are only a year away from the end of the 3 year transitional relief for Gift Aid this could be a way of maintaining if not increasing a charity's gift aid tax claim.

It should also be noted that following the announcement of an increase in the higher tax rate a number of donors will be paying tax at a rate of 50% from 6 April 2010 and the sector will need to decide how these people should be approached as they may be more willing to give money to charity rather than the Government.

In respect of non-domiciled donors who are UK taxpayers the remittance basis rules will be amended to ensure that Gift Aid is available where the donor pays tax on the remittance basis and is required to pay the £30,000 Remittance Basis Charge.

Substantial Donors

With effect from 23 April 2009 there is an increase in the amount of the threshold of relievable gifts which a person may make from £100,000 over a six year period to £150,000 in the same period. The annual threshold remains at £25,000.

Whilst this change is welcome one would still hope for a more radical reform of the "substantial donor" legislation following the formal consultation which HMRC held last year.

The matter is not dead as the Government has announced in the Budget report further informal consultation with a view to legislating in 2010.

5.85 The Government has considered its response to the consultation on the anti-avoidance rules around substantial donors to charity. Budget announces further informal consultation with the sector to develop new rules based around an effective anti-avoidance purpose test. The Government aims to bring forward proposals at the 2009 Pre-Budget report, with a view to legislating in 2010.

Review of Benefit Rules

Although there is reference to the above in the Budget material it is understood that HMRC will shortly be issuing a consultation on how to value benefits given in return for a donation. It has been suggested that the current rules are *ultra vires* and that there is need to legislate on this point in 2010.

VAT rate

It was confirmed that the reduction in the standard rate of VAT to 15% will continue until the end of 2009.

Loss-making relief

The existing concession which allows loss making companies, which we assume includes charitable companies and their subsidiaries, to reclaim tax on profits made in the last three years will continue to be available for two years until November 2010. The relief enables you to carry back up to £50,000 of the losses in total to the second and third years having fully relieved profits arising in the first year.

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Regulatory Changes – an update

Further provisions of the Charities Act 2006 have been brought into force under the fifth Commencement Order.

From 31 January 2009 it is compulsory for excepted charities with an annual income exceeding £100,000 to register with the Charity Commission. The programme of registration in fact started in October 2008 and is expected to be completed by October 2009. For those excepted charities with a lower income, the exception from registration has been extended to 2012 – which allows for a review of the Act in 2011.

From October 2009 the parts of the Act relating to exempt charities will start to come into force. This means that eventually all exempt charities (a) with an annual income of over £100,000 and (b) not subject to any other principal regulator will have to register with the Charity Commission.

New thresholds

Certain thresholds for charities have also been changed and apply to financial years ending on or after 1 April 2009.

- The threshold for requiring accounts to be externally examined is raised from £10,000 to £25.000.
- The threshold for the preparation of accruals accounts (by non-company charities only) is raised from £100,000 to £250,000. Below this amount simplified receipts on payment accounts may be prepared.
- The assets element of the audit threshold is raised from £2.8m to £3.26m and the lower income trigger for this is raised from £100,000 to £250,000.
- The threshold for registered charities to submit their annual accounts and trustees annual reports to the Charities Commission is raised from £10,000 to £25,000.

Further information is available on the websites of the Charity Commission and the Office of the Third Sector.

Our factsheet on the Charities Act 2006 will shortly be updated and expanded, and can be obtained by completing an order form. which is available on our website at **www.cvdfk.com/sectors/charities**, which also contains a list of all our factsheets.

Who to Contact

For further information or advice, please contact the author of the relevant article, your usual Chantrey Vellacott DFK partner or one of the following:

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