PKF FRANCISCLARK

Chartered accountants & business advisers

Not for Profit Bulletin

Spring 2018

Providing a topical round-up of issues of interest in the Not for Profit sector including: charities, community interest companies, educational establishments and co-operatives

supporting you and your organisation

welcome

It has been a challenging start to the year for charities with a number of high-profile scandals coming to the fore.

The President's Club scandal posed a dilemma for charities in terms of whether they should return the 'tainted' donations they inadvertently accepted. Indeed, a YouGov survey said that one in five people thought charities should return the President Club donations, and two-thirds said they should keep the money. The remaining 13% were unsure, but how easy is it in reality for a charity to give the money back?

In the wake of this scandal, the Charity Commission issued 'Advice to charities that have received donations from the President's Club Charitable Trust.' They said:

"Depending on the terms of the donations and how the funds were raised, there may be restrictions on whether a donation can be returned and the Commission may need to authorise such returns. Charities should seek the Commission's advice about whether our authorisation is required in their specific case. Trustees may wish to seek their own legal advice. The Commission does not expect trustees to return funds raised for charitable purposes in these circumstances but understands if they wish to consider doing so."

When it comes to refusing donations the rules are quite strict, a trustee would have to demonstrate that refusing money is in the commercial interests of the charity, for instance, the major donors had contacted the charity to say they would not support the charity in the future if it didn't reject the money. If there isn't a clear financial imperative, the refusal would then have to be cleared with the regulator, the Charity Commission, or the Attorney General.

More recently, Oxfam hit the headlines for all the wrong reasons regarding alleged sexual exploitation in Haiti after the earthquake in 2010. The extent to which this story made the headlines perhaps reflects the strength of feeling regarding the abuse of trust but also serves as a useful reminder of the high public standards that are expected of charities.

All charities have at their heart the desire to 'do good'. However, the recent scandals serve as a timely reminder that charities' achievements can be undone very quickly should their standards (either actual or perceived) fall short of the higher levels expected in the Not-for-Profit sector.

Should something go wrong in a charity, as we have seen in these recent scandals, it is the trustees who are accountable and who are expected to take responsibility for putting things right. Trustees should always be able to demonstrate that they are acting in the interests of the charity, part of which includes their duty to report any serious incidents which could harm their charity's reputation to the relevant authorities, including the Charity Commission.

With calls to improve transparency in the third sector, there is no doubt that transparency and accountability is a key requirement of the modern day charity. Trustees and senior leaders must review their policies and where required, consult with their advisers who will be able to offer their experience on what they see in practice elsewhere.

Duncan Leslie,
Head of Charity &
Not-For-Profit Group

Don't be a *victim*

The Annual Fraud Indicator 2017* estimated charity fraud to be in the region of £2.3 billion. Whilst charities would hope that they can rely on the trustworthiness of their staff and volunteers, and those that they interact with externally, there are no guarantees and overreliance on goodwill can be misplaced.

Charities may be particularly vulnerable where there is a small number of staff or volunteers, a high level of cash income, or unpredictability in income levels (making fraud harder to spot). Often some basic control failures leave charities open to risk of fraud.

Fraud may not only have an initial financial impact on the charity, but the reputational damage can be far greater if donors/funders lose confidence, as well as triggering potential action by the Charity Commission.

The organisation's attitude to fraud is set by the 'tone at the top'. The Trustees need to have a clear focus on fraud prevention and ensure that this is adequately communicated to staff and monitored. Ultimately the Trustees are responsible for establishing and maintaining internal control systems. No system of internal control can provide absolute protection against fraud, and whilst prevention is not cost free, it is usually better than cure after the event.

Like any effective system of control, the starting point is to properly assess the risk of fraud to the organisation, otherwise controls will either be inadequate or not cost effective.

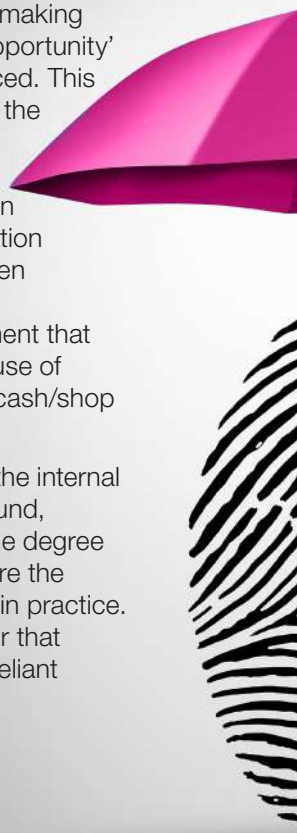
- What are your sources of income? Some may be inherently more at risk of fraud - e.g. cash collected at fundraising events, charity shop income, but what about legacy or grant income? Do you know all the points within your organisation where income is received (e.g. branches)? What are the relative levels of income from each source?
- What expenditure do you make - e.g. suppliers, payroll, how do you make payments and how often? How many people/locations can action a payment? How does IT impact the way payments are made? Is the risk of a cyber attack adequately managed?
- What assets does the organisation hold? - e.g. cash held on site, stock (in warehouse or charity shops), computers and other equipment that is easily portable?

Think about 'opportunity', 'motive' & 'rationale' for the fraudster and consider the types of fraud that might occur e.g. theft of the charity's resources, diverting income before it is recorded in the charity's books, backhanders etc.

Having considered the risks there needs to be a thorough assessment of the 'design' of internal controls (for example over purchasing to payment cycle) and whether these controls do actually prevent (ideally) or detect (promptly) the assessed fraud risks. The Charity Commissions guide 'Internal Financial Controls for Charities' (CC8) on **www.gov.uk** is a useful source of reference for the types of financial control that should exist in the organisation.

Segregation of duties is key to an effective system of financial control and even in smaller organisations it is possible to enforce some level of segregation (e.g. dual payment authorisation), even better if the segregation is reinforced by the IT systems. For example - if an individual is able to set up a supplier, authorise an invoice and make a payment without anyone else checking then the design of the system has an inherent weakness. If the IT system prevents a person who sets up suppliers also making payments then the 'Opportunity' for fraud may be reduced. This can only be effective if the controls around the IT system itself are in place (e.g. use of admin passwords). If segregation cannot be achieved then Trustees may need to consider other investment that may be required (e.g. use of CCTV in areas where cash/shop stock is significant).

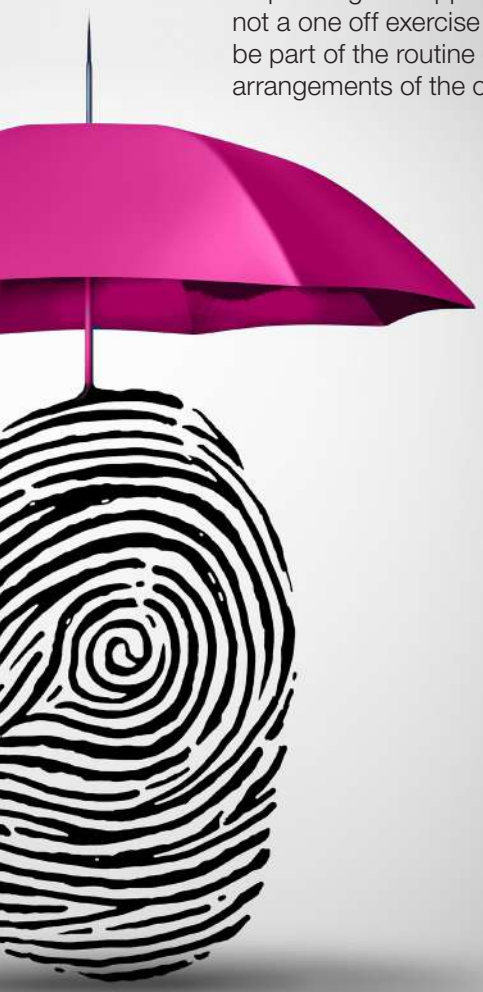
Even if the 'design' of the internal financial controls is sound, there needs to be some degree of 'monitoring' to ensure the controls are operating in practice. There may be a danger that the Trustees are over reliant



on verbal assurances from key management (the Chief Exec, Finance Manager) and need to consider where else they are getting their assurance from. Larger organisations may have the benefit of internal audit, but often it is a case of the Trustees asking the right questions of management and seeing some evidence to support what they are being told.

Charities may conclude that the cost of engaging a third party firm to perform some testing of their systems and controls is a relatively small price to pay against the potential reputational damage that a fraud might cause.

Assessing the risk of fraud and responding to it appropriately is not a one off exercise and should be part of the routine governance arrangements of the organisation.



At the organisational level, formal codes of conduct can reinforce the message from the Trustees, and an effective whistleblowing policy (including a means of reporting concerns directly to the chair of trustees) supported by appropriate training to spot the warning signs, can help deal with potential issues promptly.

If the organisation is unfortunate enough to be the victim of fraud:

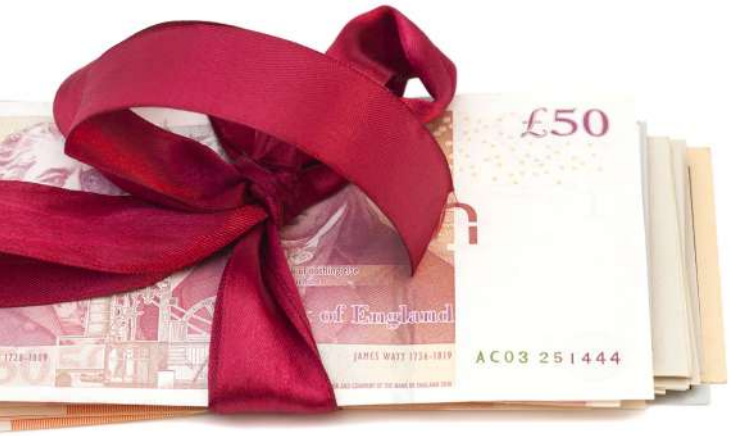
- Act quickly and review security arrangements (contact banks to cancel cards, change passwords etc.), follow your formal procedures (particularly in relation to suspected fraud by staff), and document and retain evidence.
- Maintain good communication between management and the board through what can be an unsettling time for the organisation.
- Report to Action Fraud: **www.actionfraud.police.uk**
- Report to the Charity Commission under the serious incident reporting requirements, explaining the remedial action taken: **www.gov.uk**

There are many resources available to support the sector on this issue including:

- The Fraud Advisory Panel: **www.fraudadvisorypanel.org**
- Action Fraud: **www.actionfraud.police.uk**
- **Gov.uk**

We can work with management and the board to assist in assessing and responding to the risks of fraud, including testing the design and operation of financial controls. Speak to your usual PKF Francis Clark contact if you would like any assistance.

***Source UK Fraud Costs Measurement Committee, 2017**



New rules proposed for gift aid payments by subsidiaries

Charities are faced with an increasing need to turn to trading activities for additional income. As with any company the profits from these activities are liable to corporation tax. Tax relief is available on donations made to charities under the company gift aid scheme (provided sufficient reserves are available) and it has become common practice for such subsidiaries to take advantage of this, donating taxable profits to the charitable parent to potentially reduce taxable profits to nil.

The inconsistencies in the accounting treatment of donations from trading subsidiaries to their charitable parents has been a topic of debate for some time. The Financial Reporting Council published FRED 68 on 20 September 2017 which aimed to clarify the presentation and timing of these payments in the financial statements. Those proposals have now been incorporated into FRS 102 as part of the Triennial review.

So how does FRS 102 address the issues?

Donations from subsidiaries to charitable parents should be treated as distributions to owners and recognised in reserves, not as charges against profit and loss.

There have been differences in the reporting of these payments with some subsidiaries recognising the donation in the profit and loss statement and others in equity. FRS 102 clarifies that donations represent distributions to owners and that such distributions are to be reported in equity. These distributions can only be lawful to the extent that distributable profits are available.

Donations can only be recognised as a liability where a constructive obligation exists at the reporting date.

The timing of recognition of these donations has also been a topic of debate. Commonly companies accrued for the donation at the year end and then make the payment within the following nine months to meet the requirements for tax. FRS 102 states that the liability can only be reported if there is a legal obligation (for example a deed of covenant) at the reporting date. This means that the decision to make a donation equal to the profits of the company must be taken before the results for the financial year are known. The deed of covenant can be drafted to specify that all profits will be donated to the charity, but this does tie the hands of the directors if cashflow becomes an issue. Where a liability does not exist at the year end the donation will be reported when it is paid.

Tax relief arising from the gift aid payment should be presented in the profit or loss.

Where it is probable that the gift aid payment will be made within nine months of the reporting period, FRS 102 now states that the corporation tax effect should be recorded in the current period. This means that in a group where the subsidiary always distributes all of its profits to the charitable parent the subsidiary can report that it has no corporation tax liability.

The changes in recognition of tax relief under FRS 102 can be applied immediately.

Converting to a Charitable Incorporated Organisation

From 1st January 2018 charitable companies and community interest companies (CICs) with an annual income of less than £12,500 will be able to convert to charitable incorporated organisations (CIOs). The ability to convert was previously only available to unincorporated charities.

The phased approach, based on income levels, will ultimately allow all charitable companies and community interest companies to convert from 1st August 2018.

The CIO structure is one that suits most sizes of charity and it has become increasingly popular due to the advantages it brings.

One of the main benefits is that the CIO is afforded the same limited liability protection as an incorporated charity, but without the requirement to be registered with Companies House as well as the Charity Commission. Companies House requirements therefore no longer apply to the charity.

Another important provision is that, in most cases, the new CIO will be able to receive any legacies left to the old charitable entity and any bank accounts simply transfer across. Once converted, the entity retains its name and charity number. The additional administrative burden is minimal.

A potential downside is that, being a relatively new structure, the CIO form is not as recognisable in the outside world as the traditional charitable structure. This may be of particular significance for charities operating internationally.

Before seeking conversion, CICs need to consider whether it is appropriate for them to adopt wholly charitable objects in order to comply with the Charity Commission's requirements or whether they wish to remain more commercial in their activities. The governance and external scrutiny regime is also much stricter for charities and falling under this spotlight may be an unwanted consequence of conversion. Countering this, however, charities do enjoy various tax advantages and this may tip the scales in favour of conversion.

In order to convert, a new CIO constitution must be drafted and a special resolution to convert must be made. There are model constitutions on the Charity Commission website and using these will help to avoid the application being rejected and the process being delayed. Copies of these documents must be submitted with the conversion application. The application process is simple and via a Charity Commission online form.

Please contact your PKF Francis Clark advisers if you wish to find out more or would like support with your application.

VAT REMINDERS

Income	Common VAT treatment
Admission to Premises	Normally standard rated but may be exempt.
Charity Shops and sales of goods	Zero rated if the goods have been donated. Standard rated if the goods are bought in for resale.
Catering	Normally standard rated. However some catering can be exempt from VAT when carried on by a charity. For example, catering supplied as part of welfare services or as part of a fundraising event.
Education, research and training including conference income	Standard rated but exempt if an eligible body for the education exemption.
Donations	Outside the scope of VAT provided that it is freely given, with nothing supplied in return.
Fundraising events	Events clearly organised and promoted primarily to raise money for the benefit of the charity are exempt from VAT.
Sponsorship	The VAT treatment depends on any benefit provided in return.
Grant funding	Normally outside the scope of VAT if freely given.
Hiring out buildings, including village halls	Normally exempt but will be taxable if the building is used for storage or has been opted to tax by the charity.
Membership	The VAT treatment depends on any benefit provided in return.
Supplies of staff between charities	Normally taxable at the standard rate.

In general, VAT incurred by a charity can be recovered to the extent that it relates to a taxable supply. There are exceptions to this rule for certain charities, e.g. academies and air ambulance charities. Partial exemption and non-business splits should be calculated accordingly.

Charities generate a great number of VAT queries due to the complexities of their income streams, we have set out below a number of common queries and the likely VAT treatment:

Notes

If the income relates to a fundraising event - the income may be exempt - see below.
The income may be covered by the cultural exemption (e.g. admission to museums, galleries, zoos and certain theatrical performances) and therefore exempt from VAT.

Zero rating applies to the sale, hire or export of donated goods by a charity or its trading subsidiary. By concession, zero rating also applies where goods cannot be sold to the general public but sold to scrap/rag merchants.
If a charity sells donated goods at a qualifying fundraising event, for example by auction, then the income is zero rated.

See rules below on fundraising events.

A charity, professional body or company that cannot and does not distribute any profit it makes and any profit that might arise from its supplies of education, research or vocational training is used solely for the continuation or improvement of such supplies is an eligible body.

Schools, colleges and universities are also eligible bodies.

The exemption covers admission fees for the event and any other income generated at the event e.g. sale of commemorative items, food etc.

Only certain types of event are eligible and these events are restricted to 15 events of the same kind in a financial year at any one location by the charity.

Goods that qualify for zero rating, e.g. sale of donated goods can still be treated as zero rated.

Where the charity is obliged to provide the sponsor with a significant benefit, in return the sponsorship is a business activity and is taxable at the appropriate rate. However, if no significant benefits are provided the charity may be able to treat the income as non-business.

If the grant funding is freely given, with nothing supplied in return, then no VAT is due as the funding is not considered for any supply and therefore is outside the scope of VAT.

However, some funding may be given in return for goods or services supplied by the charity. Such funding is consideration for a supply and VAT may be due on the income if the goods and/or services supplied by the charity in return are taxable at either the standard or zero or reduced rate.

An option to tax will not apply if the person hiring the building (or part of a building) from the charity is either:
- intending to use it as a dwelling (such as a residential flat above a charity shop)
- another charity who intends to use it for a relevant charitable purpose (for use as a village hall or similarly, or for a non-business purpose)
- intending to use it for a relevant residential purpose (such as a residential home for children or disabled people, or a hospice).

The provision of membership benefits to members of a club or association is a business activity. The VAT liability of a membership subscription will depend on the benefits being supplied.

If there is one principal benefit, to which all of the other benefits are incidental, the whole subscription is treated as a single supply and the VAT liability will follow that of the principal benefit. However, as a concession, charities and non-profit making organisations can treat their single supplies of membership benefits as multiple supplies. This means that the VAT treatment of each benefit can be considered individually and the subscription charge apportioned.

If staff are jointly employed there is no supply of staff for VAT purposes. Supplies of staff between VAT group members is outside the scope of VAT.

Please seek advice if the VAT treatment of the income source is not clear.

Fundraising reporting requirements

On 1 November 2016 the Charities (Protection and Social Investment) Act fundraising rules came into force. This impacts the trustees' report of larger charities (those requiring an audit with income >£1m) that fundraise from the public, and may be considered best practice for those beneath the audit threshold.

The trustees' report will need to include the following points:

- The fundraising approach taken by the charity, or by anyone acting on its behalf, and whether a professional fundraiser or commercial participator carried out any fundraising activities;
- Details of any fundraising standards or scheme for fundraising regulation that the charity, or anyone acting on its behalf has voluntarily subscribed to;
- Details of any failure by the charity, or by any person acting on its behalf, to comply with fundraising standards or scheme for fundraising regulation that has been voluntarily subscribed to;
- Whether the charity monitored the fundraising activities of any person acting on its behalf and, if so, how it did so;
- The number of complaints received by the charity, or by a person acting on its behalf for the purposes of fundraising, about fundraising activity;
- What the charity has done to protect vulnerable people and other members of the public from behaviour which:
    - is an unreasonable intrusion on a person's privacy;
    - is unreasonably persistent;
    - places undue pressure on a person to give money or other property.

The new requirements are effective for periods ending on of after 31 October 2017.

General Data Protection Regulation (GDPR)

a very brief reminder

The GDPR is a new, Europe-wide law that replaces the Data Protection Act 1998 in the UK. The GDPR sets out requirements for how organisations will need to handle personal data from 25 May 2018.

The GDPR applies to 'personal data', which means any information relating to a person who can be directly or indirectly identified.

The ICO has created a package of tools aimed at small and micro organisations, including charities. You can find the following guides on its website www.ico.org.uk:

- Getting ready for the GDPR - a practical self-assessment tool
- 12 steps to take now checklist
- A dedicated advice line for small organisations

The GDPR is an evolution of the existing law.

The GDPR requires personal data to be processed in a manner that ensures its security. This includes protection against unauthorised or unlawful processing and against accidental loss, destruction or damage. It requires that appropriate technical or organisational measures are used.

Under the GDPR, you must appoint a Data Protection Officer (DPO) if you:

- Are a public authority (except for courts acting in their judicial capacity);
- Carry out large scale systematic monitoring of individuals (for example, online behaviour tracking); or
- Carry out large scale processing of special categories of data or data relating to criminal convictions and offences.

Any organisation is able to appoint a DPO. Regardless of whether the GDPR obliges you to appoint a DPO, you must ensure your organisation has sufficient staff and skills to discharge your obligations under the GDPR.

Charity seminars

Our annual series of Charity seminars held across the region in May, will focus on the various elements involved in building a sustainable charity.

We are delighted that a number of guest speakers will be taking part this year and we believe the seminar programme will be both highly engaging and relevant to a broad range of charities.

The sessions will talk attendees through:

- Creating a vision for their charity
- Planning and obtaining funding
- Keeping the plan on track through financial reporting including VAT considerations and the risks of cyber crime
- How to create effective trustee boards
- Developing the real relationships that provide sustainable income
- Telling the outside world to ensure your fundraising messages achieve impact.

The seminar dates and venues are:

Mon 14 May	Buckfast Abbey, Buckfast, Devon TQ11 0EE
Tue 15 May	Monks Yard, Horton Cross Farm, Horton Cross, Ilminster TA19 9PT
Tue 22 May	The Tank Museum, Bovington, Dorset BH20 6JG
Wed 23 May	Epiphany House, Truro, Cornwall TR1 3DR

Each seminar will run from 9.30am - 1.00pm and will include a buffet lunch.

Please reserve your place/s online at:
www.pkf-francisclark.co.uk/events

Alternatively, please contact Devon Hawes, Events Co-ordinator
E devon.hawes@pkf-francisclark.co.uk
T 01803 320100

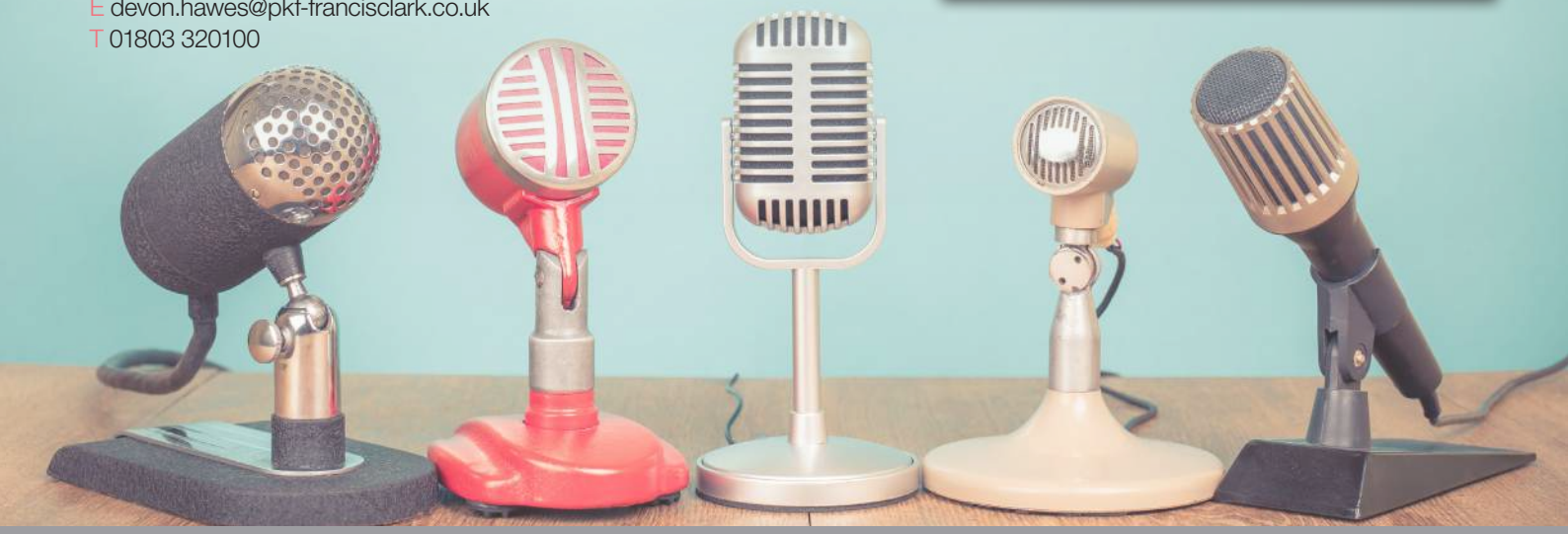
Sector updates

Since our last newsletter the Charity Commission has released one updated publication: **Receipts and payments accounts pack (CC16)** which provides templates to help eligible non-company charities with gross income of £250,000 or less prepare their trustees' annual report and receipts and payment accounts.

Draft guidance has also been released on the following:

- **Charities that are connected with non-charitable organisations: maintaining your charity's separation and independence.**
- **Charities SORP update bulletin 2 - covering updates to the Charities SORP following the amendments to FRS102 issued by the Financial Reporting Standard in December 2017.**

Further details on these and other Charity Commission publications can be found on the **gov.uk** website.



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