PKF FRANCISCLARK

Chartered accountants & business advisers

Not for Profit bulletin

supporting you and your business

Introduction

Welcome to our latest Not for Profit bulletin and my first as head of this important sector, in both the region and PKF Francis Clark. I am very proud to represent our firm in this market and have absolute confidence that conventional charities, the education sector, housing associations and community interest companies have an incredibly important role in society today.

This bulletin has a huge variety of information and I am sure there is something here for everyone that has an interest in the market. However, I just wanted to give you my perspective on the third sector landscape and what I am seeing and hearing from my clients, large and small, across the region.

Whilst it is always difficult and perhaps dangerous to look for common themes, I have noticed a link around funding. Many of my clients are becoming increasingly entrepreneurial in their attitude to income generation. Whilst this could be related to donor fatigue, or genuinely more opportunities out there, there is definitely a recognition that trying to squeeze more out of the same sources is getting harder and harder. In response, I see charities and similar organisations becoming more diverse and imaginative than ever before in trying to benefit their stakeholders in the best way possible.

Clearly, this needs to be balanced with the need to not 'bet the farm' and make sure that the mothership is protected, but a willingness to try with enthusiasm and a modicum of risk is definitely evident. This brings challenge, but also reward and an opportunity to generate a portfolio effect of income to stand the organisation in good stead for times to come.

I hope you enjoy this edition of our not for profit bulletin and do get in touch if you want to discuss any of the topics included.

Duncan Leslie,
Partner and Head of Not for Profit

Don't underestimate the effects of cyber-attacks

Cyber-attacks can affect all types of entity from big businesses to a small CIC.

You could face a variety of costs following a cyber-attack, ranging from system repair, ransom payments, customer compensation, legal costs and PR spending, to lost revenue and reputational damage.

The risk of being a victim in a cyber-attack can be reduced by adopting the Governments Cyber Essentials scheme. The scheme was introduced to help small and medium sized entities in particular know where to start and what to do in this area.

You don't have to 'trade' online to take advantage of the scheme, just about any organisation has an asset that cyber criminals would value stealing, and much too often it is small organisations that do not think they have anything worth stealing: they typically have less resources and more priorities, all making them an easy target for a cyber-criminal.

PKF Francis Clark is a certification body on behalf of the IASME consortium. IASME (information assurance for small and medium sized enterprises) is an accreditation body set up by the UK Government to roll out the Cyber Essentials Scheme which provides a set of five controls that an organisation should implement successfully to achieve a baseline of cyber security - boundary firewalls and internet gateways, secure configuration, access control, malware protection and patch management.

Fines and repercussions for cyber breaches are set to increase further with the introduction of the EU's general data protection regulation (GDPR) in May 2018, requiring many organisations to adopt much stricter processes in dealing with personal data. Where there is mishandling or breach of such data fines can be the higher of 4% of worldwide turnover or €20m. Its implementation follows serious data breaches at TalkTalk in the UK, Yahoo, and other companies, and the recent ransomware attack, WannaCry, which affected organisations in 150 countries. Organisations which are impacted by GDPR should consider IASME accreditation which is an assessment of internal controls, including those that should be in place to help with addressing GDPR requirements.

Please contact us if you would like to find out more about how we can help you.

General Data Protection Regulation (GDPR)

GDPR comes into force on 25 May 2018. Its introduction will make compliance tougher and there are bigger penalties for getting it wrong.

GDPR will supersede the Data Protection Act, and will have a significant impact on the sector, effecting how you are able to contact your supporters and process data. It raises the bar for lawful processing, making consent harder to obtain; it requires the reporting of a breach to the Information Commissioner's Office (ICO) within 72 hours; and the appointment of a data protection officer.

Are you ready for its introduction? Have you considered the impact on your organisation and how long you might need to prepare?

- What personal data do you hold?
- What do you use it for and who has access?
- Do you share your data with anyone?
- Are those individuals aware of what you do with their data?
- Are your policies and procedures compliant?

If you feel you need more information to prepare yourself for GDPR, useful information can be found in:

ICO 12 steps to take now:
https://ico.org.uk/media/for-organisations/documents/1624219/preparing-for-the-gdpr-12-steps.pdf

ICO getting ready for GDPR checklist:
https://ico.org.uk/for-organisations/resources-and-support/data-protection-self-assessment/getting-ready-for-the-gdpr/

Organisations which are impacted by GDPR should consider IASME accreditation (there are two levels - standard and gold) which is an assessment of internal controls, including those that should be in place to help with addressing GDPR requirements. PKF Francis Clark is a Certification Body on behalf of the IASME Consortium and can help your organisation with this accreditation.

Property

relevant charitable purpose and stamp duty land tax

Land and property transactions can have a significant impact on your accounts. VAT and SDLT implications could result in additional costs to a charity if they are not considered early in the process. We set out below a case study of the potential effects on a charity's accounts:

scenario

A charity plans to purchase land with an option to tax costing £250,000 plus VAT with a view to constructing a building to be used solely for a relevant charitable purpose. The VAT charged will represent a cost to the charity. The charity is not in a VAT group with its trading subsidiary.

If the charity were purchasing a building, the vendor's option to tax would have no effect if the charity were to inform the vendor before completion of the intention to use it solely for a relevant charitable purpose (note that there is no requirement for a formal certificate, however we recommend that written confirmation of intended use is provided and a copy retained). However, in this case the charity is purchasing land and there is no such provision to dis-apply the option to tax based on its intended use.

In addition, in this example the chargeable consideration for SDLT purposes would be the VAT inclusive £300,000. Therefore the charity faces £50,000 of irrecoverable VAT relating to the purchase of land and £4,500 of SDLT. This would have a significant impact on the tax cost and the charity's cash reserves, so is there any way this cost could be mitigated?

solution

The first question to ask is "when did the vendor notify HMRC of its option to tax?" If the option to tax was made more than 20 years ago, the vendor may agree to revoke it and the sale would then be VAT exempt, saving the charity £50,000 of irrecoverable VAT and £2,500 of SDLT on the VAT inclusive price.

The charity could apply the charities relief for SDLT (resulting in a saving of 100% of the potential SDLT liability) on the basis that it intends to hold the property for qualifying charitable purposes (there are clawback conditions in the event that the charitable aspect ceases with three years of claiming the relief).

If the vendor is unwilling to revoke the option to tax, another possible solution is for the trading subsidiary to buy the land with a view to constructing the building to sell the completed building back to the charity. The first grant of a major interest in a building that will be used solely for a relevant charitable purpose is zero rated for VAT purposes. As it is the intention of the trading subsidiary to make a taxable supply, it can recover the £50,000 of input VAT charged on the purchase of the land. It is likely that charities relief would still apply for SDLT purposes if the charity owns 100% of the shareholding in the subsidiary and the charity intends to hold the greater part of the land for qualifying charitable purposes.

The moral here is to seek advice on possible VAT and SDLT implications of any land or property transaction at an early stage of the process.

Governance
the charity governance code

Good governance is fundamental to your success. It is the aim of the charity governance code to help charities, similar entities and their trustees develop high standards of governance.

The code starts with a 'foundation principle'; it should be a given that all trustees understand their legal duties and are committed to their cause and good governance. The code then develops seven principles:

1. **Organisational purpose**: the board is clear about the charity's aims and ensures that these are being delivered effectively and sustainably.
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 importance of the public's confidence and trust in charities, and trustees undertake their duties accordingly.
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 for it not to be.

You are best placed to achieve your aims and objectives if you have effective governance practices and a strong leadership structure. Good governance enables and supports your compliance with relevant legislation and regulation. It also demonstrates a commitment to strong leadership to the organisation's supporters, etc.

Whilst the Code is not a legal or regulatory requirement, it draws upon the charity commission's guidance and is a tool for continuous improvement towards the highest standards.

https://www.charitygovernancecode.org/en

If you would like any assistance with reviewing or benchmarking your governance procedures against the code or best practice please speak to your local PKF Francis Clark contact.

Trustees' Report
key topics

The Trustees' Report is the first element your readers see in your financial statements. Whether you are a charity or an academy school, your Trustees' Report is a key document communicating your message to stakeholders alongside the financial information. Trustees' Reports vary considerably in length and content, with some providing an interesting read, with plenty of depth of information on the organisation's achievements and others being prepared as a tick box exercise. Whatever your approach to preparing your Trustees' Report, the financial review section is one of the key elements of focus for us as auditors and independent examiners.

Two fundamental elements of the financial review are the reserves policy and the principal risks and uncertainties. Both elements provide details to the readers of the accounts, on behind the scenes processes that should be regularly reviewed and discussed by board members.

The **principal risks and uncertainties** section should discuss the organisation's top two or three risks and the strategy for managing their risks.

These are derived from the organisation's risk register. The risk register should be collated and then regularly reviewed and updated by the trustees. Risks to an organisation often fall into two categories - strategic and operational and the two should not be confused. It is usually the strategic risks that form the basis for the principal risks and uncertainties disclosure.

In preparing the organisation's risk register, the trustees should:

- Identify the risks to the organisation and formulate a system for scoring the level of risk for each identified issue.
- Agree an acceptable level of risk for the organisation.
- Consider how the risks identified can be mitigated or managed to the determined acceptable risk level.
- Regularly review and update the risk register.

The principal risks and uncertainties disclosure will then focus in on the headline risks which the organisation faces, not simply list all identified risks.

The **reserves policy** is set by the trustees as a target level of reserves to be held. The *Charity Commission offers detailed guidance in CC19: Charities Reserves: building resilience*. There are a number of steps that you need to consider in producing a robust reserves policy:

- First - do you understand the different types of funds (i.e. unrestricted, designated, restricted, endowment, free reserves) and how they fit within your organisation?
- Second - what level of reserves does your organisation need to hold? Some questions to ask your trustees in developing the policy include:
  - What are the key risks to your organisation?
  - How could these risks impact your financial stability?
  - What are your funding cycles?
  - How do your funding streams link to your expenditure?
  - Are there separately identifiable core/project costs i.e. those that could be reduced if funding streams came to an end and those that would still need to be funded to ensure that the charity is able to continue?
  - What are the future needs of your organisation - are there any known changes or anticipated projects?
- Third - can you formulate the answers to these questions into a target reserves level or range for your organisation?
- Fourth - once a target level of reserves has been set the trustees should then continue to monitor this on an ongoing basis, building it into budgets and comparing it to the level of reserves held.

Once the 'behind the scenes' processes have taken place these can be formulated into coherent messages to include in the Trustees' Report. There is no 'one size fits all' here, both policies are unique to each organisation and require detailed consideration by the trustee board.

Revenue recognition

Revenue recognition requirements are fundamental to the preparation and reporting of financial statements regardless of the sector in which the organisation operates. As it is so fundamental, it is worth reminding ourselves of the principles and their application on a reasonably regular basis.

The Charity SORP requires the following for revenue to be recognised in the accounts:

- Entitlement to the income.
- Probable receipt of the income.
- Measurement of the income reliably.

For simple donations, the tests are clearly met. However, in the instance of a visitor attraction charity say, the scenarios can be more complex. Attendance could be paid for on the day, or via an annual membership so Gift Aid can be claimed. Consideration needs to be given to the income recognition for annual membership i.e. should an element be deferred?

The SORP discusses performance criteria (which would restrict the recognition of income) and membership income, as follows:

Although performance-related conditions can apply to any form of gift, in practice it is unusual to see performance-related conditions apply to donations. Membership subscriptions received by a charity may be in the nature of a gift, or the member may buy a right to services or other benefits. When the substance of the subscription is that of a gift, the income and any associated Gift Aid or other tax refund should be recognised on the same basis as a donation.

In other words, the membership income is still a donation and recognised on receipt, despite the ongoing rights of the donor. This is another example of the contrast between charities and the corporate world where annual membership income, of say a gym, is usually spread over the performance period.

In charities, income is often recognised ahead of the related costs being incurred, but treated as restricted in nature.

The new fundraising landscape for charities

Charities have been the target of much scrutiny and criticism in the last year or so - sometimes in an unfair and ill-informed way - in relation to their fundraising practices. Notwithstanding whether the publicity was justified or not, the reality is that following the various reviews that have taken place, the fundraising landscape now looks very different compared to a year ago.

Following the creation of the new Fundraising Regulator in July 2016, probably the biggest recent change has been the issuing by the regulator of a revised Code of Fundraising Practice. The final version of the new Code was published at the end of July 2017.

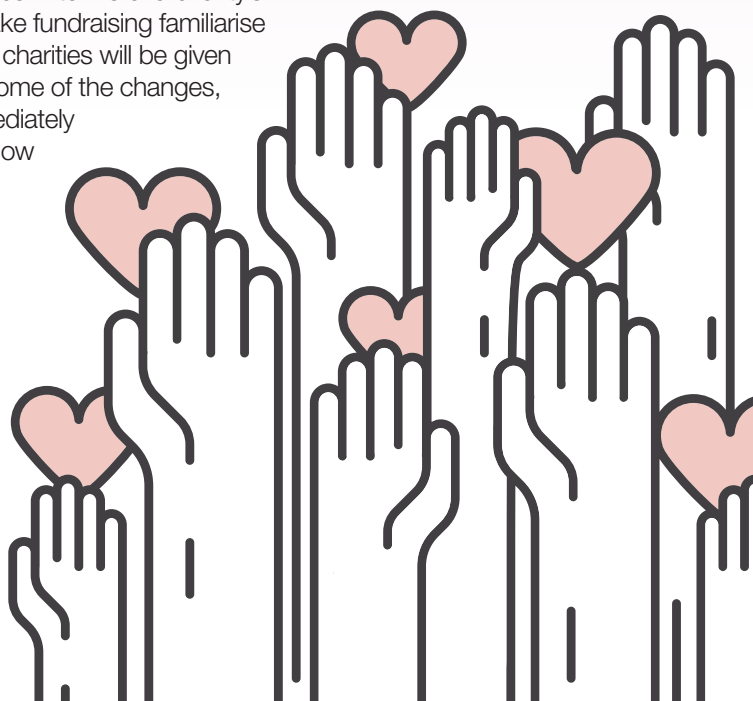
The new Code contains substantive changes compared to the previous edition, and in particular highlights six key areas of the document where new requirements have been added.

1. General principles.
2. Complaints and concerns.
3. Workings with third parties.
4. Contracts and written agreements.
5. During the call.
6. Conduct of collectors.

The changes are designed, in particular, to protect donors and to promote transparency amongst fundraisers, and include a requirement that trustees of charities must have regard to national guidance in overseeing the fundraising activities of their charities. For charities registered in England or Wales, this would include not only Charity Commission guidance, but also guidance found in the Charity Governance Code.

The new Code makes the point that the standards expected of a charity's fundraising activities apply not only to their own in-house activity, but also to the activities of any third-party organisation with whom the charity might engage to fundraise on their behalf. Failure to make 'reasonable effort' to monitor the ongoing compliance of third-party fundraising organisations with the new Code is likely to be seen to be a breach of the Code.

Whilst it can be argued that the Code merely reflects best-practice in terms of a charity's fundraising activities, it is important that all charities who undertake fundraising familiarise themselves with its requirements. The Regulator has stated that charities will be given a grace period of between two and four months to implement some of the changes, although many of its requirements should be implemented immediately if they are not already in place. We recommend action is taken now to ensure and document compliance.



Gift Aid

Gift Aid is worth over £1bn to UK charities and has been a fundamental source of revenue since its introduction in 1990. It was originally restricted to donations of over £600 and this limit was removed entirely in April 2000. Since 2006, assets other than cash have also been within the scope of Gift Aid.

The HM Treasury's (further) consultation on Gift Aid was released in November 2016 and responses are still being reviewed. Here are some comments on what may or may not work in the final proposals:

1) **Simplification**. The underlying policy intention of these reforms remains simplification. The Government hopes that its reforms will make it easier to claim Gift Aid on eligible donations and so increase the overall number and value of claims. This is an honourable objective given the relative complexity of the current arrangements which are administratively burdensome. Given the issues involved, it seems a difficult thing to achieve.
2) **Rates**. A single rate of say 10% has been suggested together with a low value disregard. In that circumstance, the Gift Aid received above that low value limit will be 15% less than previously achieved. This seems incompatible with the intention to increase the value of claims. Hence, a single rate of 10% with a low value disregard of £3 would not be welcome. Similar thoughts prevail for a 15% single rate with no low value disregard.
3) **Relevant value test**. The suggestion that benefits directly related to the charity's purpose should be disregarded for these purposes would be popular amongst donors and charities alike. How it may work in practice is difficult to see, as would a change to a cost basis.
4) **Notice period**. Any significant changes that impact charity budgets need a long lead time to consider. We think a lead time of at least a year with implementation to coincide with the tax year would be appropriate.
5) **HMRC support**. The rules and requirements are complex. A more open forum of consultation and guidance to give more clarity in trickier areas would be welcomed.

..goes contactless

Since 2013 charities have been able to claim Gift Aid on small cash donations under the 'Gift Aid small donations scheme' (GASDS). The scheme allows charities to claim an additional 25% back from HMRC on donations under £20. This can prove a useful way for charities to top-up their regular Gift Aid claims as it does not require details or Gift Aid declarations to be collected from donors. It therefore allows charities to claim back valuable Gift Aid with minimal admin.

In the past, this scheme has only been available on cash donations but from 6 April 2017 HMRC extended it to contactless payments.

From 6 April 2017, the limit for donations is now the lower of £8,000 or ten times the donations on which regular Gift Aid has been claimed. For many charities, this will mean they are now able to claim up to £2,000 per tax year in addition to their regular Gift Aid claim.

Charity commission and other updates:

Since our last newsletter the Charity Commission has released three updated publications:
https://www.gov.uk/government/organisations/charity-commission/about/publication-scheme

1) Charity governance, finance and resilience: 15 questions trustees should ask (March 2017)

This 15 question checklist is suitable for all charities, although some questions might not be relevant to your charity's size and how it operates. The checklist can help you:

- Structure discussions about what your charity does and how it does it.
- Make sure your charity is financially secure, even in tougher economic times.
- Develop plans and timetables for action.
- Demonstrate you are responding appropriately to change.

2) Charity finances: trustee essentials (CC25) (March 2017)

Assets and resources usually mean charity cash and property, but can also include staff and volunteers. When managing a charity's assets and resources, the trustees should:

- Plan for the future so the charity can meet its aims.
- Identify any risk to protect the assets and resources.
- Have a strong internal financial control policy.
- Set aside some funds as reserves to meet unexpected expenses.

3) Independent examination of charity accounts: examiners (CC32) (September 2017)

This guidance for independent examiners explains their role and duties in examining the accounts of a charity. It covers the matters which must be included in their report to the charity trustees which accompanies the accounts.

The guidance also sets out the directions to independent examiners that which must be followed in any examination which have been increased from ten to thirteen.

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Duncan leads the firm's services for the not for profit sector. He works with some of the largest and most high profile charities in the sector. He acts across a wide range of sectors in the charity space including tourist destinations, care organisations, traditional fundraising charities and those that are largely grant funded.

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