BHP Chartered Accountants

Third Sector Update

Winter 2016

In this issue we look at

- Cyber fraud
- Managing charities at risk of financial distress
- Research exercise on Charities SORP
- VAT update
- Recent developments

Editor's welcome

Lots has been happening in the sector since the summer so the focus of this autumn's newsletter is to bring you up to date with developments that may affect you.

The results of the Charity Commission's review of charity accounts that were showing a risk of financial difficulty are interesting. Particularly welcome is a key message that 'the Commission expects trustees to take seriously any concerns expressed by their charity's auditor or independent examiner and take appropriate action'. My experience is that most do but it is worth emphasising.

The outcome of the Longbridge case at the Court of Appeal has implications for charities undertaking capital projects. Depending on the circumstances this may significantly add to costs and has a knock on effect on funding.

Elsewhere Rachelle Rowbottom summarises various other developments including the outcome of the consultation of the Gift Aid Small Donation Scheme and Gavin Page looks at Cyber Fraud and the implications for charities.

Happy reading!

Jane Marshall
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Cyber fraud in the charity sector

Identified as the fastest growing area of fraud within UK businesses, cyber fraud is also becoming an ever increasing risk for charities as we continue to use technology on a more frequent basis.

It is estimated that the UK charity sector is currently losing £1.65 billion per year to such frauds, a fact that has been recognised by the Charity Commission and it is widely accepted that practises in preventing cyber fraud require improvement across much of the sector. In addition to this business cost there may also be a significant human cost for anyone involved.

What is cyber fraud?

Cyber fraud refers to any type of deliberate deception for unfair or unlawful gain that occurs online. This can transpire in many ways such as online credit card theft; email frauds or malicious software being used to bring harm to a computer system. They are not just about a loss of data but also potential losses of control, service, revenue or reputation.

Managing cyber fraud

Despite cyber fraud being based around technology, it is not a technology risk but a business risk. As a charity you have more information than the criminal, so you can defend against these attacks by highlighting your risks and ensuring that the correct people have access to the required information at the right time. It is also vitally important to ensure your staff are educated about the techniques being used by fraudsters and more importantly how they can protect themselves.

Ask yourself a few key questions

- What is at risk? (IT equipment, services and your people)
- What is your most valuable information?
- Where is the information held, and who has access?
- Are your staff trained/aware?

Whilst highlighting the mitigation techniques for cyber fraud it is worth mentioning that it is possible to acquire insurance against cyber fraud. However, this should be done with caution and only used in conjunction with internal prevention procedures. In the UK it is estimated that 52% of businesses believe they have cyber cover, whereas less than 10% actually do. Also for many of the crimes to take place it requires human action, which can invalidate the insurance. Finally, ensure polices include worldwide cover as many of the attacks are not performed from the UK so depend on worldwide jurisdiction.

Conclusion

In summary, cyber fraud has to be accepted as a risk within the charity sector and by accepting this risk we can work together towards mitigation of the risk. The Charity Commission have developed several initiatives to enhance the already good work by charities to tackle fraud, including establishing the Charity Sector Counter Fraud Group (CSCFG) which brings together over 30 charities, professional bodies and other stakeholders to enhance fraud resilience throughout the sector. The CSCFG web pages are devoted to sharing good practice in tackling charity fraud and can be found at www.gov.uk/government/collections/tackling-fraud-in-the-charity-sector-improving-resilience-and-capability.

For further information please contact Gavin Page
gavin.page@bhp.co.uk

Managing charities at risk of financial distress

In September 2016 the Charity Commission published two reports which show that trustees who take early, pragmatic steps to actively identify and manage their financial difficulties will secure better outcomes for their charities and their beneficiaries. The reports have been published as part of a proactive project exploring the financial resilience of the charitable sector and identifying wider lessons for charities who may be experiencing financial distress.

How did the Charity Commission identify charities in financial difficulty?

They identified and used audit reports with an 'emphasis of matter' paragraph about 'going concern' as a way of identifying large charities that may be in financial difficulty. They then reviewed the 94 sets of accounts submitted to them in the year ended 31 October 2015 which contained such a paragraph for those charities with a declared annual income of over £1 million.

What were the main concerns highlighted by auditors?

Auditors highlighted either indicators of financial difficulty based on the accounts, such as net current liabilities, or matters affecting the charity's future financial situation, with uncertainties over future funding being the most common concern.

Why were charities in financial difficulty?

The ongoing challenging financial environment was the underlying factor behind many of the charities' stated difficulties. Reductions in income were a major concern for charities that provided charged-for services, such as schools, or that were dependent on public sector grants or contracts, such as those providing leisure and arts services, or that needed to continue raising large amounts of voluntary income.

Other charities were dealing with set up or restructuring costs, pension scheme deficits, unplanned overspends or contingent liabilities, such as claims against the charity.

What actions were trustees taking?

The most common response was to generate more income, through increasing the number of people using the charity's services, diversifying sources of income or fundraising. Others concentrated on plans to manage a specific financial risk, such as a pension scheme deficit. The trustees of those charities in most serious difficulty were restructuring their charity's activities or considering winding it up.

How successful have the trustees' actions been?

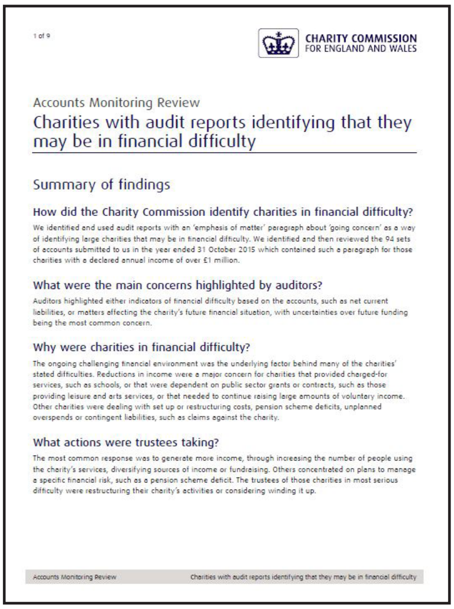
57 charities have now filed a more recent set of audited accounts. The financial positions of 14 charities had improved sufficiently for the auditor not to include an emphasis of matter paragraph in their audit report. By contrast, the auditors of 5 other charities consider that they are no longer a going concern. An additional 9 charities have ceased to operate.

What action has the Commission taken?

As a result of the Commission's scrutiny, 5 of the charities were referred and included into the complementary programme of proactive inspection visits to charities with signs they are in financial distress. Regulatory guidance to help the trustees of charities which are facing financial difficulty has been updated ('Managing a charity's finances: planning, managing difficulties and insolvency (CC12)'). 69 of the charities that are continuing to operate and with which the Commission were not currently engaged have been contacted to remind them of their duties and responsibilities and provide them with guidance, including a link to the updated version of CC12.

What are the lessons for other charities?

The review has highlighted the challenges that the difficult financial environment presents for charities and some of their strategies for dealing with them. It has also highlighted the difficult but crucial role that charity trustees and their senior management have in managing situations of financial distress.



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CHARITY COMMISSION
FOR ENGLAND AND WALES

Accounts Monitoring Review

Charities with audit reports identifying that they may be in financial difficulty

Summary of findings

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Accounts Monitoring Review — Charities with audit reports identifying that they may be in financial difficulty

Some key messages are that:

- being prepared to address financial difficulties effectively is an important part of a trustee's duties to act in the charity's best interests, manage the charity's resources effectively, and ensure the charity is accountable - charities that are able to identify pressures and risks early are best placed to address them
- the Commission expects trustees to take seriously any concerns expressed by their charity's auditor or independent examiner and take appropriate action in response
- guidance has been provided to help trustees identify and deal with situations of financial difficulty.

The full reports are available from:

https://www.gov.uk/government/publications/accounts-monitoring-charities-with-audit-reports-identifying-that-they-may-be-in-financial-difficulty

https://www.gov.uk/government/publications/charities-at-risk-of-financial-distress-group-case-report

For further information please contact Jane Marshall
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Research exercise on charities SORP (FRS102) - have your say

The current research exercise, which is in progress, is intended to identify the necessary changes for the next Statement of Recommended Practice: Accounting Reporting by Charities (the Charities SORP (FRS102)).

The invitation to comment sets out five areas of research where views are sought on how the next SORP could be improved. The aim is to identify any necessary changes in good time to prepare the next Charities SORP (FRS102) with an Exposure Draft of the next SORP anticipated for 2018. It is expected that the next SORP would take effect from 2019.

The joint SORP-making body and SORP Committee seek your views on five specific areas for potential SORP development including:

- the SORP's structure, format and accessibility
- implementation issues that require improvements to the SORP
- SORP Committee member suggestions for changes to the SORP
- charity regulator themes for making changes to the SORP
- your ideas for items to remove, change or add to improve the SORP.

Responses are welcome on one or more of the areas identified. If responding to two or more areas, you may wish to submit your comments either as a single response or instead choose to submit a separate response for each section. All responses must be received by the closing date of 11 December 2016 if they are to be considered.

The consultation document is available from the SORP microsite http://www.charitysorp.org/

For further information please contact Jane Marshall
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VAT update

The Court of Appeal has recently handed down what could prove to be a landmark judgement in the Longridge on Thames case.

Longridge is a charity which provides boating and other water- based courses, activities and facilities to mainly young people and groups working with the disabled. The charity receives grants and donations but these do not cover the costs of running the activities and consequently they have to make charges to the users to cover the shortfall.

The issue before the court was whether Longridge were carrying out a business activity. If this was the case they could not benefit from the zero rate relief for new charity buildings.

The question as to whether the activities of charities are undertaken by way of business is a vexed one. There is no definition of business in UK VAT legislation and when the question has reached the Tax (VAT) Tribunals there have been many, often contradictory decisions.

In Longridge's case the Court found that there was a direct and immediate link between the activities carried out by Longridge and the money it received

from its users. Longridge were therefore in business for VAT purposes and consequently could not benefit from the zero rate relief for new charity buildings.

So, why do I think this decision is so important?

- This is the first time that the Court of Appeal has been asked to decide a case concerning business activity since the European Court handed down its decision in the Finland legal aid case. The decision therefore carries more weight than the decisions of the Tax Tribunal.
- The decision seems to say that there will be a business activity where there is a supply of goods or services irrespective of the amount charged or the motives of the charity- good news when the supply would be subject to VAT (more opportunity for VAT recovery) but bad news if it is exempt (no VAT recovery).
- The decision appears to limit the circumstances where a charity can take advantage of the zero rate relief available for new charity buildings
- We may at last have some much needed clarity on this issue.

HMRC are yet to comment on this issue and we do not know whether Longridge will be able to appeal further but it seems to me that this decision makes it more likely that charities will be regarded as undertaking business activities than was previously the case.

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Recent developments affecting the sector

Charities and litigation: a guide for trustees CC38

The Charity Commission recently published new guidance for trustees regarding taking or defending legal proceedings. It has been prepared to help trustees to comply with their legal obligations and assist them in their duty to act in the best interest of the charity and manage risks. The guidance can be found at https://www.gov.uk/government/publications/charities-and-litigation-a-guide-for-trustees-cc38.

Just Giving fees

September 2016 sees the launch of Just Giving's fair pricing approach, which is the first change to the pricing structure since its launch over fifteen years ago. Before this date all charities using the site paid a subscription charge of £15 plus VAT per month. This fee level will remain for charities raising up to £15,000 in the 12 month period June to July, although very small charities will pay nothing (at the time of printing details are yet to be released). Large charities, which are those raising more than £15,000 in the 12 month period, will now pay £39 plus VAT per month.

Business rates relief

Substantial savings from business rates can be achieved where charities occupy property due to charitable rate relief.

The savings provide landlords of empty property with a potential opportunity. Full business rates are payable after the three month empty property relief period has expired. As a result of this, some charities have been approached by landlords to enter into tenancy arrangements so that they can benefit from the savings.

Charities should consider any such arrangements carefully to determine if they are in the best interests of the charity. This includes considering whether the property meets its needs and is genuinely required to enable it to fulfil its charitable purposes.

Gift Aid Small Donation Scheme

The outcomes of the consultation that took place earlier this year have now been published and a number of changes to the scheme have been identified:

- the eligibility criteria will be amended to make the scheme more available to smaller and newer charities;
- the scheme will be extended to include donations made by contactless payments;
- charities will be able to claim the community buildings amount/s or the main allowance, but not both;
- donations collected within the local authority area of the community building will be eligible for the scheme.

At the time of printing, it is expected that the changes will be effective from 6 April 2017.

New social investment power

Following the introduction, on 31 July 2016, of the first phase of the Charities (Protection and Social Investment) Act 2016, charities now have a new statutory power enabling them to make social investments. The Charity Commission have published guidance for trustees which can be found at https://www.gov.uk/government/news/updated-guidance-as-new-social-investment-power-for-charities-comes-into-force.

For further information please contact Rachelle Rowbottom
rachelle.rowbottom@bhp.co.uk

Save the date!

Chief Executives and Chairs – a date for your diary!

BHP are delighted to be teaming up with Irwin Mitchell to bring you a new event on **17 January 2017** aimed at charity Chief Executives and Chairs.

The theme of the morning workshop is "Getting the best from your greatest asset – your people" and topics covered are likely to include hiring and retaining the right people and dealing with underperformance.

However, whilst short presentations will be given by experts from Irwin Mitchell and BHP, the workshop will be interactive and attendees are invited to submit questions and issues of concern beforehand which the presenters will then discuss solutions to at the event. There will also be plenty of opportunity to put questions to the speakers on the day.

The event will be held at the Leeds office of Irwin Mitchell.

Please send any questions and issues you would like raising to louise.bright@bhp.co.uk.

So get your thinking caps on – and we look forward to seeing you there!

Specialist advisors to the charity sector and not for profit sector