Third Sector Update

Autumn 2018

BHP Chartered Accountants

In this issue we look at:

Editor's welcome

At the beginning of October the Charity Commission unveiled its purpose as part of a new Statement of Strategic Intent. The statement sets out the Commission's core purpose and priorities for the five years to 2023. That new purpose, to ensure charities can thrive and inspire trust so that people can improve lives and strengthen society, will inform everything the Commission does going forward.

In her speech Baroness Stowell, Chair of the Charity Commission, said "Our great challenge is that charities are not always living up to the public's expectation that being a charity is about how we behave, not just what we set out to achieve. The public, quite reasonably, expect a charity to have charitable aims, and to be a living, breathing expression of charitable behaviour and attitude. By working on this together, charities and the Commission will help ensure that charities thrive, so that people can improve lives and strengthen society."

The statement sets out a different tone from the Commission and an important one. All of us in the charity sector need to work together to ensure charities live up to what the public expect from them. Whilst this demonstrates joined up thinking from the Charity Commission, HMRC's announcement on Making Tax Digital shows a quite unbelievable misunderstanding of the fundamentals of the charity sector where VAT is concerned. Simon Buchan's article looks at the implications of this.

I hope you will find the updates in this newsletter useful, as ever do let us know it there are topics you would like to cover in future issues.

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Mergers and due diligence

Lesley Kendrew gives some tips for charities considering mergers.

Over the last few years, we have assisted many charities who were considering the need to merge for various reasons, including growth, funding and economies of scale. The academy trust sector is currently highly active with trusts both acquiring and releasing schools to alternate trusts.

Regardless of whether your charity or academy is merging, being taken over, or is the entity leading a takeover, careful thought and due diligence must be undertaken by the trustees of each charity, as they have the ultimate responsibility for governance and directing how the charity is managed. It may be that a formal merger is not necessary and rather collaborative working for a specific project is more appropriate.

The consideration of a potential merger and which charity or academy would be appropriate, can be a great opportunity for the current trustees to stand back and take an overview of their charity's status and to review its current governing document.

Prior to committing costs and time to the due diligence process, the trustees should ensure that their governing document gives them the legal power to achieve the merger, or whether they require permission from The Charity Commission. Regardless of whether the governing document requires the consent of members and beneficiaries, it is often valuable to obtain their views pre-merger.

The trustees of each charity must be happy that any potential merger is in the best interests of their charities; will continue to enhance the ethos, culture and values of each; and continue to deliver the objectives of each charity to their beneficiaries, which should result in a more efficient service by increasing opportunities and income streams whilst making resultant cost savings.

Set out below are some thoughts for consideration when dealing with potential mergers.

From the Finance perspective:

- Carry out appropriate due diligence procedures to ensure the financial information for the merged organisation can be relied upon
- Produce cash flow forecasts, projections and a feasibility study for the merged entity

continued on page 3

Charities SORP Update Bulletin 2

The SORP Committee published Update Bulletin 2 to the Charities SORP (FRS102) on 5 October 2018, Jane Marshall looks at what has been amended.

The update bulletin applies to all charities in the United Kingdom and Republic of Ireland. It is presented in three sections: clarifying amendments; significant amendments; and other amendments.

Other amendments are distinguishable from significant amendments as they are either less significant or are only likely to impact on a small number of charities. These are not covered in this article.

Clarifying amendments are applicable to reporting periods beginning on or after 5 October 2018 (bulletin publication date), since they merely clarify existing requirements, and include the following:

- Charities must provide comparative information for all amounts presented in the accounts, including the notes to the accounts, unless FRS102 specifically says otherwise **(Module 3: Accounting standards, policies, concepts and principles, including adjustment of estimates and errors).**
- Payments by a subsidiary to its charitable parent should be accounted for consistently with dividends. This means gift aid should only be accrued in the individual accounts of the parent charity where there is a legal obligation to make the payment. A constructive obligation is no longer acceptable. A deed of covenant creates such an obligation. (**Module 5: Recognition of income, including legacies, grants and contract income, Module 13: Events after the end of the reporting period).**
- Until now, charities could argue that the cost of determining the depreciation charge for assets comprising two or more major components with substantially different useful economic lives presented undue cost and/or effort. This exemption has now been removed as it is regarded as inconsistent with FRS102 and so charities must depreciate each component separately **(Module 10: Balance Sheet).**

Significant and other amendments are applicable for periods beginning on or after 1 January 2019. Significant amendments have been made to various sections of the SORP as follows:

Module 10: Balance Sheet
Where a charity rents investment property to another group entity, in its own accounts it is now permitted either to measure the investment property at fair value or to transfer it to tangible fixed assets including it at cost less depreciation and impairment.
Mixed use property should be split between investment property and property held for operational use as a tangible fixed asset if the resulting portions could be sold or leased separately. However, it is no longer possible to argue that measuring the investment property component of mixed use property at fair value results in undue cost or effort. This exemption has been removed.

Depreciation is not provided on investment property measured at fair value. No disclosure is required where stock is recognised as an expense.

Module 14: Statement of cash flows
Charities must now prepare a reconciliation of net debt as a note to the statement of cash flows.

Module 27: Charity mergers
A charity reconstruction that should be accounted for as a merger, is extended to include the transfer of activities to a subsidiary undertaking.

Appendix 1: Glossary
A definition of the term "service potential" has been included being the capacity to provide services that contribute to achieving a charity's objectives without necessarily generating net cash flows.

For further information please contact Jane Marshall
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Tax update

Rachelle Rowbottom highlights some recent sector specific tax developments.

Gift Aid Awareness Day
BHP supported Gift Aid Awareness Day on 4 October which was promoted by the Charity Finance Group. It is estimated that £560m of Gift Aid goes unclaimed each year and the aim of the campaign was to increase awareness amongst charities, their staff, volunteers and donors. The hash tag #tickthebox was used to encourage eligible donors to complete Gift Aid declarations and tick the box. There continues to be a lack of understanding regarding Gift Aid and everybody in the sector has a role to play in reducing the amount that is unclaimed.

Charity registration
Plans to have a joint portal for charities to register with HMRC as well as the Charity Commission which were announced in 2013 have now been scrapped. In addition to Charity Commission registration, charities must therefore continue to register themselves as a charity for tax purposes with HMRC via the following link https://www.gov.uk/charity-recognition-hmrc.

GDPR and Gift Aid
HMRC has updated its Gift Aid guidance to include reference to the requirements under the General Data Protection Regulations (GDPR). Specifically, HMRC has acknowledged that charities may want to include more than just the standard information on a Gift Aid declaration. For example, the charity may feel that it is necessary to include content regarding GDPR. Charities should review their Gift Aid system and record keeping in light of the requirements placed upon them by GDPR.

For further information please contact Rachelle Rowbottom
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Mergers and due diligence - continued

- Consider the costs of the merger and the transfer of assets into one entity
- Consider potential risks of the merger and put plans in place to manage the process
- Review the projected merged balance sheets
- Consider how deficits on pension liabilities will be dealt with at an early stage
- Compute merged restricted, unrestricted and designated fund balances, consider any that are in deficit and the joint level of free reserves
- Consider whether there any restrictions on each charity's sources of income that could affect future funding streams
- Consider the view of current and future funders including bankers. It is important to consider if the merged entity will attract more funding and whether there are increased opportunities to obtain grants
- Review prior period audit reports to establish if any were modified or qualified and consider the impact upon future funding streams
- Prepare Key Performance Indicators and ways to identify and monitor the results of the merged entity once up and running

From a Structure and Governance perspective

- Consider the various types of legal entities that are available ie. a charitable trust, charitable company, Charitable Incorporated Organisation or collaborative working, and decide which is most appropriate
- Consider whether to set up a new charity or merge into an existing one
- Produce a new governing document
- Consider an appropriate name for the new entity and any re-branding opportunities
- Elect the new board of trustees
- Consider the optimum number of trustees and skill set required
- Appoint a chair of trustees
- Appoint a chief executive and key management personnel who must have the appropriate skills to deal with the new larger entity

From a Laws and Regulations perspective

- Review risks and policies including safeguarding
- Contact institutes, societies and bodies relevant to the charity eg Ofsted, Care Quality Commission
- Update Disclosure and Barring Service checks for staff and volunteers
- Contact HMRC regarding VAT, gift aid, employment taxes
- Contact the Land Registry if land or buildings are to be transferred
- Deal with Employee notifications, TUPE and pension requirements
- Consider changes to leases
- Review current insurance policies and consider any new requirements
- Review software licences and future requirements
- Consider regulations for increased government reporting eg: gender pay gap reporting, large supplier payment reporting, and the new Trade Union Regulations 2017

This is not an exhaustive list and the requirements and considerations will vary depending on the objectives and purpose of individual charity.

For further information please contact Lesley Kendrew lesley.kendrew@bhp.co.uk

Making Tax Digital - an update

With MTD just around the corner, Simon Buchan gives an update on announcements made by HMRC and what this means for the third sector.

On 17 October 2018 HMRC made two significant announcements re Making Tax Digital (MTD)

- the MTD for VAT pilot has now exited the controlled go-live phase and is open more widely for sole proprietors and limited companies meeting the entry criteria; and,
- mandation of MTD for VAT will be deferred by six months for a small number of businesses with more complex requirements.

The MTD for VAT pilot

Limited companies and sole traders can now sign up for the pilot, provided they have a MTD compliant accounting system. However, there are exceptions. Amongst others- partnerships, trusts and charities are unable to enter the pilot at this stage.

We are expecting the pilot to be extended to include all of the businesses currently excluded in the future.

Deferral of mandation for more complex businesses

MTD for VAT will now not be mandatory until 1 October 2019 for businesses that fall into one of a number of categories including:

- trusts
- 'not for profit' organisations that are not set up as a company
- VAT groups

To my mind this announcement sums up HMRC's muddled thinking on MTD and on the charity sector in general.

I fail to see how trusts and "not for profit organisations that are not set up as companies" have more complex VAT arrangements than those who are companies. Both have to deal with partial exemption and business/non – business issues and therefore the logic as to why these issues cause more difficulty for trusts than for companies is a mystery to me.

However, we are where we are, and no doubt those charities who can take advantage of the extra 6 month deferral period will no doubt be grateful for the extra time allowed to comply with MTD.

For further information please contact Simon Buchan simon.buchan@bhp.co.uk

News in brief

In our regular feature, we look at the latest news from the Charity Commission.

Automatic disqualification

On 1 August 2018 charity automatic disqualification rules changed to include new reasons for disqualification of trustees and some charity senior manager positions (chief executives, finance directors and those in equivalent roles). New reasons for disqualification include being named under particular anti-terrorism legislation, being on the sex offenders register and being in contempt of court.

You should ask your trustees and senior managers to confirm that they are not disqualified. If you are setting up a new charity you must also confirm that your trustees are eligible and not disqualified to act in this role.

If someone is disqualified, they need to stop acting in their role but can apply to the Charity Commission to have their disqualification waived.

The Charity Commission has released guidance for charities which includes a handy, downloadable disqualifying reasons table and sample declarations for current trustees and senior managers to state that they are not disqualified from acting in these positions.

This can be found on:
https://www.gov.uk/guidance/automatic-disqualification-rule-changes-guidance-for-charities

Annual Return

The 2018 annual return service is now available. For 31 March 2018 year ends the deadline for submission is 31 January 2019. Make sure you file early to avoid any last minute rush.

You should also ensure you check the financial information in your annual return is accurate. The Charity Commission recently checked over 300 annual returns and found input errors (picking the wrong figures out of the accounts) to be the most common reason for inaccurate annual return data.

Another common error we see is where a charity states their accounts were 'qualified' rather than 'unqualified'. Many small charities wrongly believe 'qualified' to mean there were no issues with their accounts, rather than the actual meaning that the auditor or examiner has some reservations.

A person familiar with the charity accounts should complete or check the annual return before submission to avoid any errors occurring. Please speak to your usual BHP contact if you have any queries.

Public Benefit reporting

Charity Commission research found an improvement in charities' understanding of public benefit reporting. Over 51% from a sample of 106 larger charities demonstrated a clear understanding of the public benefit reporting requirement, an increase from 46% the last time the research was conducted. For those not meeting the requirement, further guidance was provided to trustees. The Commission concluded these trustees had given little thought to the difference that their charity's activities made to beneficiaries.

Do you need volunteers?

BHP recognises that the firm and its employees have a significant role to play in the communities within which we work and live.

BHP actively encourages its employees to add value to the many voluntary and community organisations who rely on volunteers to achieve their objectives. To support this, earlier this year we implemented a volunteering day which allows our employees to take one day of paid work time per year for community volunteering.

Do you have a project that we could help with? Do you offer volunteering days? We would love to hear from you.

Our CSR committee is currently requesting ideas from charities about the volunteering programmes that they offer.

This information will then be advertised to our staff to see if it is of interest.

Please email info@bhp.co.uk with the subject 'CSR volunteering' with your ideas for how we can get involved.

Unfortunately, we cannot commit to all projects that we may become aware of, the emphasis at BHP is about employee engagement and choice. However, we will ensure our staff are made aware of what opportunities are available.