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Charities & Not for Profit Newsletter

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Whistleblowing

The Charity Commission is a 'prescribed person' which provides the statutory framework for employment protection to individuals within charities who 'blow the whistle' on a suspected wrongdoing, including regulatory breaches by employers.

In 2017-18 the Charity Commission received 101 whistleblowing reports compared to 88 the previous year. Of those, 82 reports potentially required regulatory action, while 19 were deemed low risk.

At present 50 cases remain open. Governance continues to be the greatest area in which employees whistleblow followed by safeguarding, which has also seen the largest increase.

The Charity Commission have 5 objectives when it comes to whistleblowing as follows:

1. Increase public trust and confidence in charities.
2. Promote awareness and understanding of the operation of the public benefit requirement.
3. Promote compliance by trustees with their legal obligations in controlling and managing their charities.
4. Promote the effective use of charitable resources.
5. Enhance the accountability of charities to donors, beneficiaries and the general public.

Further, the Commission has a range of statutory powers including:

1. Power to gather information or documents
2. Temporary protective powers whilst investigations are underway
3. Remedial powers allowing the implementation of long term solutions

The Commission are conscious of their approach to whistleblowing. They understand that at times it can be difficult for employees to bring a matter to their attention and the importance to the individual for reporting the issue. Therefore the Commission aims to be approachable.

When investigating a report, the Commission follows the approach set out in the Regulatory and risk framework. The framework ensures their engagement is proportionate, accountable, consistent, transparent and targeted.

Positive impacts have been seen from cases of whistleblowing including allowing action to be taken to protect charity beneficiaries, assets, and importantly public trust.

Reports have also identified other governance issues which have subsequently been addressed and ensure charities are complying with safeguarding issues.

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Judith Coplowe - Partner

Overseas donations – protecting your charity’s tax exemptions

Charities have generous tax exemptions on their income and profits. However, in order to secure these, all funds must be applied for charitable purposes. This includes donations made to overseas entities. UK charities must be able to prove to HM Revenue and Customs (HMRC) that they have taken **reasonable steps** (due diligence) to ensure that the overseas entity has applied the donated monies for a charitable purpose.

What constitutes reasonable steps is a subjective test and HMRC will look at each case individually but there is little guidance from them on this point. Factors which will influence the level of due diligence required will include, but is not limited to, the number of donations made, the size of the donations and the nature of the overseas entity.

HMRC can deny an amount of the charity’s tax exemption equal to the size of the donation where it is not satisfied that a UK charity, or ultimately its trustees, have taken sufficient care to ensure that the donation overseas has been applied for charitable purposes.

For all donations made to an overseas entity the trustees must be able to:

- Describe the steps taken;
- Explain how these steps ensure charitable application of the funds donated;
- Demonstrate that those steps were reasonable under the circumstances; and
- Produce evidence that the steps were actually taken.

The trustees should maintain an ongoing record of their knowledge of the overseas entity and their relationship with it. This would include details such as whether the entity is a registered body, confirmation of the credentials of the entity and those who represent it, a record of the regulations the entity is required to abide by and details of where a copy of the annual



accounts of the entity can be accessed or requested.

The trustees need to be able to show how each application for a donation progresses from the initial enquiry to the final decision to make a donation. This should be supported by minutes of any meetings, or copies of any correspondence relevant to the decision making process and will include the purpose and terms of all applications for a donation.

After each donation is made the trustees should seek evidence from the overseas entity that the donated funds have been applied as intended. Suitable evidence will include receipts for donations, a review of the financial statements of the entity including its annual accounts, bank statements, supporting invoices, copies of any contracts or agreements between the charity and the overseas entity or even visits to witness the progress of a funded project. Any conclusions reached whilst analysing these documents should be recorded appropriately. Depending on the sums involved it may be prudent to involve a third party to audit how the funds granted have been applied.

To conclude, it is the responsibility of the trustees to ensure that a challenge from HMRC can be effectively defended to protect the charity’s tax exemptions.



Charities SORP Update Bulletin 2

The SORP Committee published Update Bulletin 2 to the Charities SORP (FRS102) on 5 October 2018. It applies to all charities in the United Kingdom and Republic of Ireland. The bulletin 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 will not be 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.

Quality of charity accounts

Most of the information available on public record is collated through the completion of the annual return; a requirement for all registered charities.

However, recent research has shown the information recorded is not always accurate. Reports from the Charity Commission show that:

- 26% of larger charities filed accounts of an “unacceptable quality”
- 36% of small charities filed accounts of an “unacceptable quality”

Charities with income over £500,000 are deemed larger charities and must provide a detailed analysis of income and expenditure to the Charity Commission.

The main reasons for larger charities failing to meet the quality expected were:

- Either the accounts or annual report were missing.
- The annual report provided little or no information on the charitable activities being carried out.
- The independent examination report was inadequate.
- The accounts were incomplete or did not balance.

Small charities are those with income less than £25,000 and represent over two thirds of all charities on the register. Details need to be provided on income and expenditure but there is no requirement to file trustees’ annual report and accounts with the Commission. When a sample were contacted, a quarter only provided either the trustees’ annual report or accounts or neither document, with a third of the accounts reviewed omitting key information. This highlights that many trustees of small charities remain unaware of their legal duties to produce a trustees’ annual report and accounts.

Small charity burden

The SORP Committee, which produces the accounting rules for the charity sector, are looking at the possibility of allowing small incorporated charities to prepare receipts and payments accounts.

Presently, only unincorporated charities and CIOs are allowed to prepare this simpler form of accounts when income is less than £250,000. This income level would also apply to incorporated charities. We’ll update you on this in due course.

The next full SORP is anticipated to be due in 2021.



Public Benefit Reporting

Commission research found an improvement in charities' understanding 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.



Charity shops survey

The charity shops survey has been issued for the 27th time and is compiled and written by Charity Finance with support from the Charity Retail Association.

The headlines results are as follows:

- Overall profitability is up for the first time in three years by 2.7%. Average weekly profit per shop was £516, up from £471 the previous year.
- Retail income increased by 3.8% and expenditure by 3.9%.
- Shop volunteering hours have also seen an increase. The average number of volunteer hours per shop is at its highest ever, at 134.8.
- For the first time in over a decade there was a decrease in the number of charity shops. This could be because the sector has reached maximum capacity, or perhaps because some shops are being opened in out of town environments and are therefore much larger or more specialist, e.g. furniture.
- Charity shop managers expect to see an increase in shop numbers next year, with 61% predicting new shops opening.
- Average results per shop, for a non-hospice shop were:
 - Annual rent £18,723.
 - Staff costs represent 39% of turnover
 - 17.8 volunteers per shop and 5.1 hours per volunteer.
- Average weekly sales of £1,833.
- Average weekly profit of £361.
- National charities paid an average rent per annum of £23,623 whereas the average for smaller charities was £16,686. The size of specialist shops has increased to an average of 1,759 square foot and it has been noted that out of town outlets see a better rate of return than smaller high street stores.
- The price of rag has increased by over 9%, which has boosted profits. The average rag price increased from 42p to 45p per kilo, however this is still significantly lower than in 2014 when it was 60p per kilo.
- Charity shops have also seen an increase in income from online sales through third party sites, such as eBay or by using online auction sites for niche or unusual furniture.
- Stability seems to have been reached following the recent introduction of pension auto enrolment, the national living wage and the apprenticeship levy. However current concerns include:
 - The possibility of dwindling volunteer numbers if another recession occurs due to Brexit.
 - Poor quality donated stock.
 - Competition from other charity shops.
 - Health and safety of customers and staff.

Engagement of workers – VAT and employment tax developments

Back in 2011 the First Tier Tribunal held that supplies of temporary staff by the Reed employment agency were supplies of introductory and ancillary services, and thus VAT was only due on the commission element charged by Reed.

HMRC had been of the view that Reed was making a supply of staff and that VAT should have been due on the whole amount received from the recipient of the services. Emboldened by the decision in the Reed case, the Adecco recruitment agency, charged VAT solely on the commission element of their services. HMRC argued that the whole amount should have been subject to VAT and the case went to court. Rather unexpectedly at the time, Adecco lost at both the First Tier and Upper Tribunal but fought on and appealed to the Court of Appeal. In August 2018 the Court of Appeal rejected Adecco's appeal. The reasoning was as follows:

- The temps did not supply their services under contracts with the clients as no such contracts existed;
- The contracts between a temp and Adecco referred to the temp's services being supplied 'through Adecco';
- Adecco conferred control of the temps to the clients;
- Adecco paid temps on its own behalf not as agent for the clients; and
- Adecco did not 'drop out of the picture' once it had introduced a temp since it was responsible for paying the temp regardless of receiving payment from the client.

The Court of Appeal rather than simply distinguishing the facts in Adecco from the facts in the Reed case, stated that the Reed case had been decided in error. This would appear to shut the door firmly on other recruitment agencies who may have been tempted to challenge HMRCs' position.

Having lost three times, it is unlikely that Adecco will appeal further. The decision is disappointing for the charitable sector as the cost of using temporary staff has considerably increased as many charities are unable to recover all of the VAT incurred.

The recruitment of staff through third parties is also a very topical area with HMRC from an employment taxes perspective as evidenced within recent HMRC employer compliance reviews. This is particularly relevant in the charitable sector where there is pressure to minimise costs and permanent headcount.

Employers should keep their arrangements for the engagement of workers under review to ensure unexpected tax issues do not arise. For example, HMRC introduced new payroll requirements from April 2017 the public sector covering off-payroll engagements or engagement through personal service companies and have recently consulted on expanding this to the private sector. There is speculation that the widening of these measures will be announced by the Chancellor in the 31 October Budget, and if this is correct any new requirements will likely place another burden on the charitable sector.

Warning - Charity clothing collection fraud

Charity clothing bags are regularly posted through letterboxes, however the Fundraising Regulator has issued a warning to the public to be aware of potentially fraudulent collections. Unfortunately some of the commercial organisations used to carry out clothing collections are not doing so on behalf of a charitable organisation.

Key steps to ensure you are donating clothes to a genuine collection are as follows:

1. Is there incorrect spelling, poor grammar or punctuation on the bag? This is a sign the collection may not be genuine. You can contact the charity directly to check that there is a collection in your area.
2. Does the bag specify a named charity or describe a general charitable cause? Genuine collections should be in the name of the charity.
3. Is the collection company licensed? Genuine companies collecting donation bags should be vetted and you can check this by contacting the licensing team at the local authority.
4. Is a logo visible on the vehicle used to pick up donations? Be wary if bags are collected in an unmarked vehicle.
5. Does the bag state the name and registered company number of the collector on both sides of the bag? This information should be included in the same size font as the name of the charity the collection is taking place for, not in tiny print. The bag should also state how much the charity will receive from the donation, which is probably £x per tonne of donated clothing etc.

The public is being urged to report a collection believed to be illegal to the local council and if in doubt to take donations directly to their local charity shops.

HMRC

HMRC have recently updated their guidance relating to phishing scams to say that they might genuinely telephone a charity to discuss compliance checks. This advice is also relevant to mid-sized businesses and public bodies.

The guidance gives advice on what steps can be taken to ensure that the call is genuine.

Any emails coming from HMRC should include their name and end in @hmrc.gsi.gov.uk.

No deal BREXIT?

The NCVO has recently posted a webinar on charities and BREXIT. The overriding thought was that the Chequers plan looks fairly unlikely to be agreed given the Government have until the 21 January 2019 before they are required to issue a statement with a plan for BREXIT. The key themes were that:

- The treasury have agreed to underwrite the European Social Fund should a no deal funding pledge occur- this means that any EU funding that has been awarded up until 29 March 2019 will be honoured by the Government. NVCO are advising that charities **still apply for EU funding** as this agreement is for all funding awarded up until the point that Britain leaves the EU.
- The European Union (Withdrawal) Act will protect workers' rights once we leave the EU – this, in the short term, should give Charities comfort that they will not have a mass exodus of staff.

The biggest fear is that as BREXIT is likely to cause a time of uncertainty, there will be a growing need for the services of the Charity sector, with no pledge for increased income available from the Government. Even though workers' rights are protected there could be a reluctance for EU citizens to work in the UK which may increase the difficulty in finding and recruiting staff.



Finally given all the policies that will need to be negotiated, it is recognised that policies for the Charity sector are likely to be regarded as less important and will be tackled last.

Charity Commission response to NCVO Code of Ethics

The Charity Commission have issued their response to the National Council for Voluntary Organisations consultation on the draft Charity Code of Ethics.

PEM reviewed the draft Charity Code of Ethics in our August newsletter. The Charity Commission's view is that voluntary codes set by the sector should promote higher standards than regulators can expect or require and therefore they broadly welcome the code. They have suggested that statements about moral leadership should be stronger, that risk and risk appetite need to be considered and have questioned

whether the draft code has been sufficiently tested for ease of practical application by a range of different charities.

They have also questioned how the code will be promoted, implemented and then monitored once it has been adopted.

The Commission is keen to see close alignment and mutual support between the Code of Ethics and the Charity Governance Code to make adoption of both straightforward.

About us

Our experienced Charities and Not for Profit team offers expert advice and support for all areas to suit your specific needs. Please meet our Charities and Not for Profit team who will be happy to talk to you about any issues you may have.

For further advice, information or to feed back please do not hesitate to contact Judith Coplowe on 01223 728283 or email jcoplowe@pem.co.uk



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