Price Bailey
CHARTERED ACCOUNTANTS

Spring 2023

Charities and not for profit newsletter

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Welcome

Welcome to our Spring 2023 edition of the Charity and Not for Profit Newsletter, which has continued as a blog series over the year on our website. This edition brings together recent articles published on our website into a newsletter.

It includes our article on fraud and the latest Economic Crime and Corporate Transparency Bill. The article reflects on the implications for businesses if this Bill is passed in its current form, making fraud a corporate criminal offence. We also look at the 2023 Charity Commission Annual Return and the new questions required to be answered from this year in its completion. Finally, we have an article on Kids Company, summarising the various findings over the last few years and the Charity Commission report issued last year and what these mean if you are a Trustee of a charity.

We have also issued a separate newsletter on FRED 82 – the draft FRS 102. The FRC has proposed that for accounting periods beginning on or after 1 January 2025, a new version of FRS 102 will apply.

A revised Charity SORP will also be issued for consultation to take account of any changes that are relevant to charities. Charities do need to be engaged in the process so that we can make the accounting standard better for the sector. The newsletter sets out some of the key areas of FRS 102 which affect charity accounting. You can download the full newsletter here. Please do respond to the consultation and take part in the process to try and change the accounting standard for charities.

Please do not hesitate to contact us if you need more information on anything we have raised.

Stop press: Legal update

01. Online Safety bill

Another Bill currently making its way through Parliament is the Online Safety Bill which is due to be completed and be in force by the Summer 2023. The Government has said the Bill delivers its "manifesto commitment to make the UK the safest place in the world to be online while defending free expression".

The Bill introduces new rules for firms which host **user-generated content**, i.e. those which allow users to post their own content online or interact with each other, and for search engines, which will have tailored duties focussed on minimising the presentation of harmful search results to users. Such platforms that are in scope of the legislation will need to tackle and remove illegal material online, particularly material relating to terrorism and child sexual exploitation and abuse. Failure to do so could result in fines of up to ten per cent of their revenues.

If the Bill remains as drafted, then for charities, this is likely to cover private chat services and the requirement to proactively scan messages and the implications as a result.

02. The Charities Act 2022

The Charities Act 2022 has received Royal Assent and gives charities wider or additional powers and flexibility:

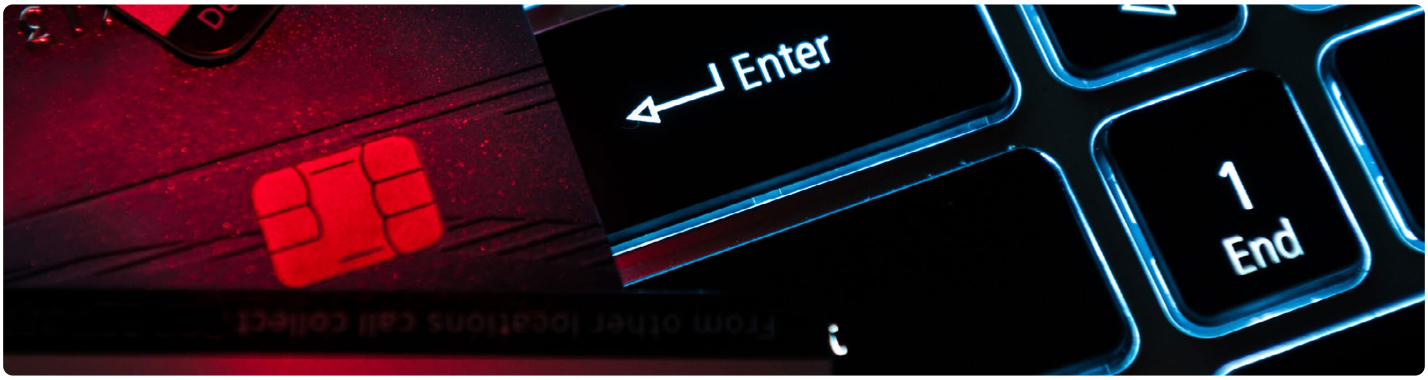
- to amend their governing documents;
- to decide on how they procure goods and services;
- to make "ex gratia" payments;
- Clarify when property can be applied cy-près, including the proceeds of failed fundraising appeals. ["Cy-pres" means "as near as possible" to direct that the funds be used for other similar charitable purposes.];
- Produce a clearer and less administratively burdensome legal framework for buying, selling, leasing and mortgaging charity land;
- Clarify and expand the statutory regime that applies to permanent endowment;
- Introduce a power, with appropriate safeguards, for charities to borrow from their permanent endowment and to make certain social investments using permanent endowment;
- Facilitate, where appropriate, charity mergers and incorporations;
- Confer additional powers on the Charity Commission:
    - to authorise charities to pay an equitable allowance;
    - to require charities to change or stop using inappropriate names; and
    - to ratify the appointment or election of charity trustees where there is uncertainty concerning the validity of their appointment or election;
- Improve and clarify certain powers of the Charity Tribunal;

In October 2022, the first set of changes introduced by the new Charities Act 2022 came into force. These include:

- a new power that trustees can use to be paid for providing goods to the charity;
- where fundraising appeals do not raise enough money, or too much, simpler and more proportionate rules will apply (cy-pres);
- power to amend Royal Charters.

The other provisions included in the Act will be brought into effect during 2023 and will make it more straightforward for charities to change their governing documents, grant more flexibility in using 'permanent endowment funds' and allow greater flexibility around the advice needed when selling land.

Fraud: Responsibility and culpability is changing



Under the current climate, with individuals struggling due to the cost of living crisis it is more important than ever for organisations to assess and manage their susceptibility to fraud. This could be seen as giving staff incentive to commit fraud.

Charities and NFP clients do tend to operate on a higher level of trust than their corporate counter parts. If only I was given a pound for every time I was told as an auditor "we trust our staff". Such an attitude is not appropriate as it places undue pressure on the honesty of employees, and in situations of financial hardship can lead to a justification/**rationalisation** of taking a small amount that then cascades to more frequent or larger amounts. If appropriate control environment, checks and balances were in place then such temptation might never occur.

Currently organisations do have a duty of care to protect their employees from harm. This covers reasonably foreseen acts or omissions that are likely to harm employees. A lack of appropriate financial oversight and control would fall into this category, and give staff and fraudsters **opportunity.** Employers should have appropriate controls to protect their employees from temptation. If your control environment is inappropriate and not robust, and an individual commits fraud, then are you complicit in the perpetrated fraud?

Fraud needs incentive, opportunity and rationalisation to take place. Employers have the ability to stop opportunity through effective controls.

Economic Crime and Corporate Transparency Bill

Currently, this Bill is making its passage through Parliament. It will allow the Government to move faster when imposing sanctions, provide the ability to cease crypto-assets, and will create a Register of Overseas Entities (ROE) so as to be able to target foreign criminals laundering money in the UK and reforms at Companies House – such as identity identification of all existing and new directors at Companies House.

However, perhaps less known is that a 'failure to prevent fraud, false accounting or money laundering' could be become a new criminal offence. The House of Commons on 25 January 2023 tabled new additions to the draft legislation to include this new corporate criminal liability that will mean that it brings responsibility onto the entity and thus its key management for failings in the internal control environment that allowed fraud, false accounting or money laundering to occur.

Currently, if there is a failure in the control environment that allows a fraud to take place, there is a requirement for prosecution to demonstrate that management were fully aware of the weakness in order to be able to take proceedings. This would completely change the onus of proof to just the weaknesses existing in the control environment that allowed the activity to take place. Hence it will mean that the onus will be on the organisations will need to demonstrate that they have documented potential fraud, false accounting and money laundering opportunities and how these will be managed through preventative measures. So watch this space, as the goal posts could move significantly.

Auditors

Another change in the fraud arena is the International Standard on Auditing (UK) 240 – ISA 240. This ISA comes into effect for all audits ending on or after December 2022 onwards (and even earlier in certain circumstances such as shorter accounting period). Because of this change, audit fees have to increase due to the level of additional work required on all audits as a result. There is also an updated ISA 315 applicable to the same audit periods, which has enhanced requirements also driving audit fee increases, but it is not covered by this article.

ISA 240 requires auditors to undertake substantially more audit work around potential for fraud. Fraud meaning the fraudulent reporting and misstatements arising from the misappropriation of assets It encompasses assessing how fraud could occur, understanding the systems and controls in place, documentation of these the same and reporting on any weaknesses or issues arising. Therefore, we as auditors are also now focusing more work in this area too.

Fraud assessment and controls

So what should you be doing? Assess the ability of fraudsters to commit a fraud in your organisation and how to prevent it.

In order to demonstrate your duty of care as a responsible and caring employer you need to assess your fraud risk and have appropriate controls. The New Economic Crime and Corporate Transparency Bill will be driving the need for robust systems and controls to be able to demonstrate your defence if prosecuted in the future, should you be subject to a fraud. This fraud assessment needs to look at both external and internal fraud.

We have seen or heard about successful frauds perpetrated on clients by staff, but more commonly now fraud is instigated by outsiders who are able to circumvent controls and receive funds. The estimated fraud loss to the UK economy last year was £193bn and this figure is increasing.

When thinking about fraud, think about how funds and assets could be targeted. There are two types of controls – active and passive. Active controls look to prevent fraud occurring cover aspects such as segregation of duties, physical control over assets, sequential numbering for instance of sales invoices, signatures and counter signatures and passwords. Passive controls are looking to detect if fraud has occurred such as reviewing audit trails, internal or external audits, surveillance of personnel or controls and reviewing procedures.

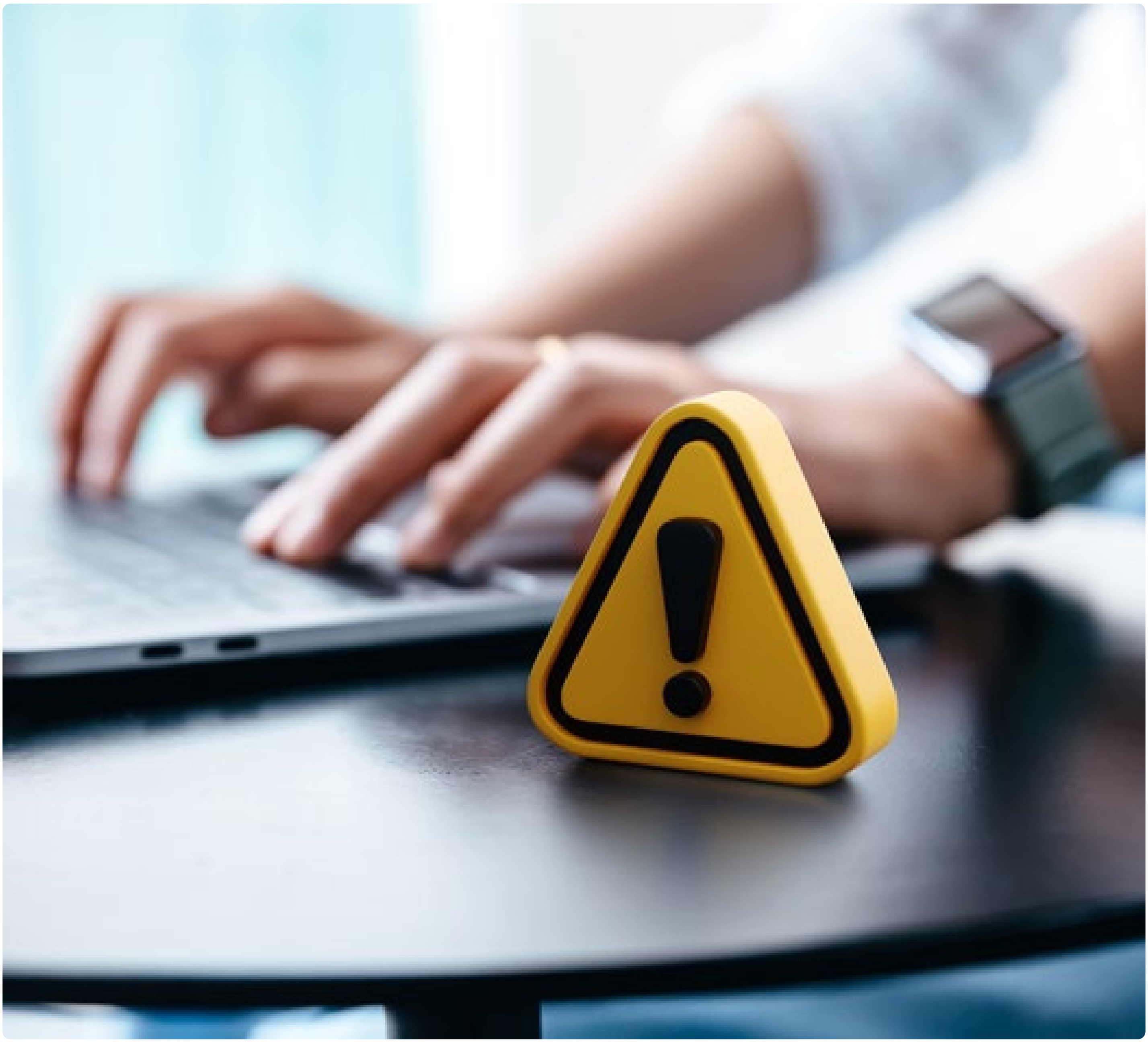
Let's consider an example:

Do you have effective procedures in place which prevent bank account changes occurring to suppliers and employees without appropriate checks and balances? We have all heard about supplier statement frauds, but the latest is changing employee bank details that only work for one month. Therefore, is every bank account change authorised by someone other than the person who initiated the change? Are the bank accounts verified by a named contact at the organisation, or directly with the employee, by telephone? Sending emails is insufficient, fraudsters can intercept email traffic and have even diverted genuine supplier telephone numbers too, so that only direct contact with the named person would have prevented the fraud. How is this process documented and evidenced of having taken place? Do you review supplier and payroll audit trails to confirm all changes are authorised?

"Employers should have appropriate controls to protect their employees from temptation. If your control environment is inappropriate and not robust, and an individual commits fraud, then are you complicit in the perpetrated fraud?"

Next steps

We would recommend that all organisations start to look at ensuring they have effective control environment in place as soon as possible, as changing controls will take time. The new Bill is rapidly going through Parliament and the consequences of not taking action could result in a criminal record and even imprisonment if it remains unchanged.



Kids Company collapse: What it could mean for Trustee responsibilities

The collapse of Kids Company in 2015 started a series of events that are still ongoing even today.

In 2016 the Public Administration and Constitutional Affairs Committee Report (PACAC) published a report that stated "The Board failed to protect the interests of the charity and its beneficiaries (...) Primary responsibility for Kid's Company's collapse rests with the charity's Trustees."

High Court findings

Five years on and after costing the public some £9.5m, the High Court's Judgement in 2021 concluded very differently. The Judge stated that most charities would be delighted to have individuals with the abilities and experience of these Trustees and the care and commitment the trustees had shown in highly challenging circumstances. An important and vital driver of the decision-making was to ensure that able and experienced individuals are not dissuaded from becoming or remaining trustees.

There was recognition that whilst aspects of Kids Company operating model were high risk, it was not unsustainable in principle and the charity had laid out a restructuring plan. If it had not been for the unfounded sexual assault allegations it is more likely than not that the restructuring would have succeeded, and the charity would have survived.

The charity's CEO, Camila Batmanghelidjh, did have a central role that included developing strategy, but she was subject to supervision and control by the trustees, who were the ultimate decision makers. The High Court recognised that the trustees did exercise real scrutiny over expenditure but most importantly, it stated that they were entitled to expect staff to draw any major concerns to their attention and gain comfort from external reports. Thus referring to a proportional view of Trusteeship, recognising that it is not a full time operational role and therefore reliance does need to be placed on key management of the Charity to update and inform the Board. As a result, the Trustees' conduct did not amount to incompetence of a high degree.

Charity Commission findings

In contrast, in February 2022 The Charity Commission report that was published did assign blame for the failings of Kids Company on the Board of Trustees. There is a clear divergence of opinion from the High Court ruling by the regulator that found there was 'mismanagement in the administration of the charity' at both the Board and senior management level. The Charity Commission report is highly critical of the Board and senior management and the role they played in the Charity's collapse. The report is critical of the Board role saying that a greater breadth of experience in the trustees and a broader range of skills might have meant they were better placed to question the executive's decisions including the service delivery model adopted.

The Charity Commission highlighted the high-risk business model was predicated on a heavy reliance on grants and donations and on the CEO as a key fundraiser, whilst having a lack of reserves. The Trustees were aware of these risks but continued to operate under the same model for many years, only developing a restructuring plan in the last months of the charity's operation. In its report, The Charity Commission highlights the four key lessons learnt from Kids Company **as follows:**

- The importance of checks and balances, and the right blend of skills and knowledge, in charity boards;
- The requirement for operating models to reflect the nature and scale of the charity;
- The role of financial planning and reserves policies;
- Considerations for when charities grow.

The report does emphasize some key messages for Boards to take away; it reminds Boards that part of their role, when evaluating whether their approach is effective, is measuring impact of the charity. **They need to ensure that:**

- There are effective systems in place;
- They understand their income risks and dependence, particularly if from one source of funding;
- They understand their cash-flows and their reserves;
- They understand at what level reserves are maintained and why has this level been set;
- Where reserves are low, there must be a clear explanation of the operational ability to continue in the Trustees' report;
- Finally, in respect of fundraising itself, the budgets needs to be realistic, monitored and regularly assessed on actual performances achieved and so the risks arising on income generation are actively managed.

All of this is sound advice, especially in our current climate of increasing inflation, utility costs and increased service demand – it creates the perfect storm.

This thought process has flowed through the 2023 Charity Commission annual return that has been updated with several new compulsory income questions.

- Charities with incomes over £100,000 now need to disclose the value of the highest value donation received from both an individual donor and a corporate donor;
- For overseas income received, there is a need to disclose income by country and then sub-analysed by source, such as from governments, private companies or overseas donors.

The report also recommends that all charities could consider setting an agreed term of office for trustees so as to bring fresh perspective to the Board and to avoid complacency. It concludes that diversity across trustee boards leads to better decision making and challenge of the executive, following on from the criticism of the skills and breadth of experience of the Kids Company Board.

Next steps

In December 2022, Camila Batmanghelidjh has been given permission to go to High Court over her claims that the Charity Commission report is irrational and tainted by bias in the form of predetermination to produce a report which was critical of Kids Company. The Judge concluded that the grounds were arguable but there would be high hurdles as the Courts would not readily interfere with a decision by an expert regulator. We wait to see how the next steps in the Kids Company saga develop.

At the moment, this leaves Trustees in a quandary. On the one hand you have a position whereby the High Court ruled that Trusteeship is proportional and it is right that Trustees should place reliance on information and reports provided by management in their decision making. On the other, you have the Charity Commission report which looks for the Boards to be responsible for all aspects of charity management and challenge information provided to them. Both points of view are valid, but without proportionality, Trustees are unable to fulfil their duties without a significant time commitment and burden which goes above and beyond the current governance structures in place, which are limited by time available to Boards in a handful of meetings a year.

The hope is that the view of the Charity Commission is scoped further in order to give Trustees the comfort they need in order to fulfil their duties or be paid to spend the time required to deliver against the Charity Commission's remit, which would involve substantially more involvement in the day to day operations and processes. Volunteer Trustees who are working full time may find the time requirements of such a role challenging. Diversity requirements of recruiting younger Trustees onto Boards will be limited if the responsibilities of a Trustee are as wide as the Charity Commission viewpoint.

Charity Commission annual return for 2023

The Charity Commission annual return for 2023 applies to all returns for financial statements starting from 1 January 2023.

What's changing?

The effect is detailed below – 10 additional compulsory questions for all charities; and up to 13 extra in total depending on your charity type. 6 questions will be removed in 2024 so that the maximum number of questions will decrease to 43 for the 2024 and 2025 years.

	Existing Annual Return	Existing Annual Return
Maximum number of questions	36	49
Annual baseline – the core questions that would be answered by all respondents	16	26
Sub-questions, responded to only by respondents with relevant operations or data	20	23

An overview of what the new questions are focused on is as follows:

Income: All charities, including those with income under £500,000, need to record their total income analysed by donations and legacies; charitable activities, other trading and investment income. Furthermore charities with income over £100,000 need to disclose the highest donation amount received from a corporate donor and also from an individual donor and if these are from related parties.

Trustee payments: New question on any payments to trustees regardless of whether it's in their role as Trustee or a connected entity or for payments for goods or services. Out of pocket expenses are excluded.

Grant Makers: Disclosure of the value of grants made to the categories of individuals, other charities and non-charities; and disclose details of grants made to related parties.

Overseas charities: Many new questions in this area and additional disclosures over both funds received and spent. Will need to confirm how any income outside of the UK is received from abroad, whether any charitable services were provided outside of the UK or if funds were spent outside of the UK.

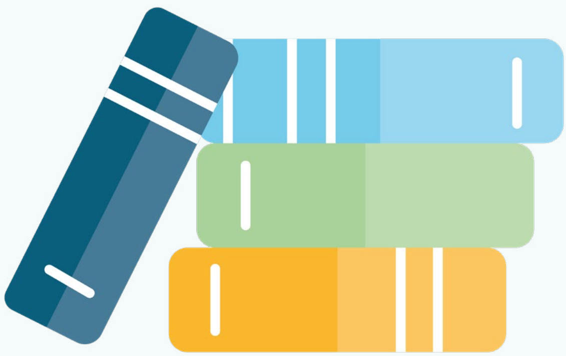
In particular for overseas expenditure to disclose the total spend per country and how this was remitted to nearest £100 not using regulated banking services and in such circumstances what methods were used. For overseas income similarly for each country disclosure of the value of income received in the categories: governments or quasi-government bodies (including the European Union); charities, non-government organisations or Not For Profits; private companies and individual donors resident outside of the UK.

Premises: Confirmation that the public address on record is correct and if this is the charity's headquarters or otherwise disclose this address.

Staff: New questions being asked. Requirement to disclose at the balance sheet date how many people were permanently employed; were on fixed-term contracts and how many were self-employed; and of these to disclose how many work outside the UK. Disclosure of estimated number of volunteers who carried out charitable activities in the UK during the year and if appropriate DBS checks were undertaken for all roles that are eligible for them.

Structure and governance: There is a question of whether the charity is a member of a wider group as a parent or subsidiary. New question on whether members, other than Trustees are allowed to vote under the governing document. A new question which specifically asks a charity to confirm from a list which policies and procedures are in place at the balance sheet date which covers basic financial policies and procedures as follows:

1. internal charity financial controls policy and procedures
2. safeguarding policy and procedures
3. financial reserves policy and procedures
4. complaint's policy and procedures
5. serious incident reporting policy and procedures
6. internal risk management policy and procedures
7. trustee expenses policy and procedures
8. trustee conflicts of interest policy and procedures
9. investing charity funds policy and procedures
10. campaigns and political activity policy and procedures
11. bullying and harassment policy and procedures
12. social media policy and procedures
13. engaging external speakers at charity events policy and procedures



Our Not For Profit team

This newsletter is from our Charity and Not for Profit team at Price Bailey, if you have any questions about any of the points raised in this newsletter please contact us here.

We always recommend that you seek advice from a suitably qualified adviser before taking any action. The information in these articles only serves as a guide and no responsibility for loss occasioned by any person acting or refraining from action as a result of this material can be accepted by the authors or the firm.

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