

Charity Newsletter



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Introduction

The country is currently suffering from a much heightened period of political and economic uncertainty with the war with Iraq in progress.

Whilst many organisations within the voluntary sector will need to respond to the numerous crises that this type of situation creates, they must do this notwithstanding the impact on their own finances due to poor investment performance and reduced donations.

I am sure many of you will have read about the government's Strategy Unit Report which could have a significant impact on how many charities will operate in future. On page 1 we have summarised the key recommendations and considered what action should be taken, if any, at the present time.

In addition, we have considered how charities should react to financial problems if they arise and have included the usual round up of news and ideas which I hope you will find helpful. Our Budget Newsletter will be issued following Budget Day on 9th April 2003.

Richard Robinson
Charities Partner



Private Action Public Benefit Review of September 2002 Strategy Unit Report



In his foreword to this document the Prime Minister admitted current law relating to charities is out of date, unclear and not designed to reflect modern conditions. The package of measures set out in the report are aimed at addressing these issues and modernising them. Whilst the consultation process has now ended there has not yet been any clear indication of when the enabling legislation will appear. This article reviews the main proposals and considers how these will affect the way charities operate in future.

Revision of charitable purposes:

- 1 . Prevention and relief of poverty
- 2 . Advancement of education
- 3 . Advancement of religion
- 4 . Advancement of health
- 5 . Social and community advancement
- 6 . Advancement of culture, arts and heritage
- 7 . Advancement of amateur sport
- 8 . Prevention of human rights, conflict resolution and reconciliation
- 9 . Advancement of environment protection and improvement
- 10 . Other purposes beneficial to the community

Whilst on the face of it these could allow a massive expansion of charitable activity, the existing criteria dating back to 1601 which broadly encompassed numbers 1, 2, 3 and 10 above proved to be adequate enough to allow 188,000 charities to register to date.

Key new areas are the inclusion of amateur sport, human rights and the prevention (in addition to relief) of poverty. Organisations involved in these areas will need to consider whether obtaining charitable status should be part of their longer term plans for when the law change occurs.

On the negative side, charities which charge fees for the services they provide may in future have to prove to the Charity Commission that these charges do not discriminate against less well-off members of the community. It may be necessary therefore for private schools for example, to show that they have bursary schemes to demonstrate equal opportunity to all prospective pupils.

Trading

Charities have tackled this issue for many years through using a separate trading subsidiary. Although a change in the tax rules has recently allowed charities with modest trading activities (maximum turnover £50,000) to avoid this route many charities have now accepted the additional costs and management that the two company structure involves.

The recommended change to the law will allow charities to undertake all trading within the charity but there will be a statutory duty of care imposed on trustees. Trustees will need to consider the following issues:

- ❖ Whether operating the trade within the charity would expose the charity to risk.
- ❖ Whether proper professional advice has been obtained in relation to any decisions made on trading structure.
- ❖ Whether the trading activity itself is suitable for the charity (eg, the operation of a casino is unlikely to be a suitable trade).
- ❖ Whether when comparing trading with other forms of income generation it is economically justified.



Advocacy

At present charities cannot have political objects and are restricted in pursuing their objectives through argument and lobbying. The proposed recommendations will allow charities to campaign but the best interests of the charity must continue to be maintained.

Mergers

There are many small and medium charities which have similar objectives and suffer from economic pressures due to a high level of administrative costs compared to income. Whilst merger may be the obvious answer to this situation the red tape involved in doing this has often been a barrier to the commencement of negotiations.

The recommendations propose that:

- ❖ It will become easier to change the charity's purpose.
- ❖ It will be easier to change the governing documents.
- ❖ The approval of schemes will be speeded up.
- ❖ There will be an automatic transfer of legacies and gifts.
- ❖ There will be a "light touch" applied to due diligence in charity mergers.

Legal framework

At present charities who operate through companies must adapt the commercial format of contracts to suit their charitable needs. Furthermore, social enterprises which are not necessarily charities cannot currently use a format which will protect their assets or allow them to raise equity finance.

To tackle these problems the strategy unit has recommended two new company formats with tailored characteristics.



Community interest companies

Features -

- ❖ Protection of assets against distribution to members or shareholders.
- ❖ Option of either limited by guarantee or shares format.
- ❖ Borrowing allowed through fixed interest rate preference shares.
- ❖ Statement of objects.
- ❖ Regulation to ensure objects are in public and community interest.
- ❖ Increased transparency.

Charitable incorporated organisations

Features -

- ❖ Members limited liability
- ❖ Available for charities with and without members.
- ❖ Flexible administrative powers.
- ❖ Model constitution with plain English requirement.
- ❖ Mechanisms to ease conversion from other formats.

Charity regulation

Organisations that rely on public fundraising or volunteer help must hold the confidence of those they approach for help. The strategy unit has examined the quality of accountability, information and fundraising practice and has made the following recommendations:

- ❖ For charities with a turnover of £1M the completion of an annual Standard Information Return requires charities to compare outcomes with objectives and explain its governance and accountability.
- ❖ Continued improvement of the charities SORP, especially to aid inter-charity comparison.
- ❖ An update of local authority fundraising rules.
- ❖ The formation of a self regulatory body for fundraisers.
- ❖ The encouragement of performance improvement and the establishment of benchmarking for different charity sectors.

The encouragement of trusteeship by developing training within the National Curriculum, allowing payments to any trustees who can provide specific skills to the charity's benefit and the limitation of personal liability.



Operation of the Charity Commission

There are a wide range of recommendations relating to organisational issues and giving targets for the Commission's future activities. Those that affect charities more directly are:

- ❖ The audit threshold to be increased to £1M with an independent examination being required for all charities with income over £10,000.
- ❖ The threshold for compulsory charity registration to be increased to £10,000.
- ❖ The status of "small" charity to be applied to those below the £10,000 registration limit.

Conclusions

The report includes a total of 61 recommendations which cannot all be mentioned in this article. The key question must be how should charities react now. Although the consultation period is now over, there is no indication of when the government will place any of these measures on the statute book.

The only advice at present therefore must be for charities to make short term strategic decisions based on current legislation and the best interests of the charity. Longer term planning should at least have regard to the proposed changes referred to above.



Managing Financial Difficulties

Charities that undertake government funded activities or receive European grants are forced to walk a financial tightrope every year due to the uncertainty of contracts being renewed and the tortuous grant application process.

Trustees are therefore being forced to make difficult decisions relating to cash flow management and staff retention which are often completely contrary to the provision of the valuable services they provide to their beneficiaries.

Coupling this with reduced Lottery funding and a fall-off in donations, many charities are now facing financial difficulties for the first time in their history.

The Charity Commission has produced a very useful booklet to aid charities who find themselves in this position called "Managing Financial Difficulties and Insolvency in Charities". Having talked to a number of charities over the years who have found themselves under financial pressure, based on this experience we believe there are a number of key actions that must be undertaken:

- ❖ Trustees must be kept fully and regularly informed about the charity's financial situation.
- ❖ Budgets and cash flows must be prepared, it is often necessary to cover a number of alternative scenarios.
- ❖ Actual outcomes should be monitored against budget and any variations followed up immediately.
- ❖ Key parties must be kept informed about the situation, such as the bank, grant providers, government funders and in most cases, the employees.
- ❖ Trustees should take advice from the charity's accountants and solicitors to ensure the charity is continuing to act legally and all appropriate actions have been taken.

Hopefully solvency problems do not arise for the majority of charities and if they do, with prompt attention and decisive action they can be corrected. Charity trustees have a duty to act prudently in administering the financial affairs of the charity and if an insolvent situation is allowed to arise through their inattention to this responsibility they could become personally liable under certain circumstances. Trusteeship can be very rewarding for those that are prepared to give up their time for the public benefit but the responsibility they have for the financial health of their organisation must not be ignored.



Employment Issues

Redundancy

In the current climate, redundancy may be an issue that charities need to consider. As a basic guide any entitlements paid under the employee's contract or according to a staff manual are taxable. Otherwise, if the payment is actually compensation, then it is likely to be exempt from tax up to a limit of £30,000. Statutory and non-Statutory redundancy payments are also generally exempt up to £30,000. Payments in lieu of notice (PILONS) are considered to be damages if a period of notice is contractual and therefore exempt up to £30,000. Please contact us or your local Inland Revenue office for advice in advance of making any payments if there is any doubt. Charities may also find it advisable to seek clearance from the Charity Commission for ex-gratia payments.

Other employment issues

The proposed Conduct of Employment Agencies and Employment Business Regulations mean that charities that make use of employment agencies for temporary staff will incur extra VAT. Current regulation means that VAT is charged on the agency's commission only. Under the proposals, VAT will also be charged on the wage cost.

Charities are very likely to have experience of being taken to an Industrial Tribunal and this situation will probably be exacerbated by ever more complex legislation. Charities should ensure that they keep up to date with developments and regularly review dispute procedures. A tribunal can be expensive in costs and time and damaging to the morale of employees.

National Minimum Wage

It has recently been announced that the National Minimum Wage rate will increase in October by 30 pence to £4.50 per hour for employees aged 22 and over and by 20 pence to £3.80 per hour for employees aged 18 to 21. An indicative rate of £4.85 for over 22's has been suggested for next year.

Payroll Year End Deadlines

To avoid interest charges, the deadline for the final payment to the Collector of Taxes for 2002/03 is 19 April 2003. As this is the Saturday of the Easter weekend, the real deadline is Thursday 17 April.

All of the statutory returns (form P35 annual return, form P38A supplementary return, forms P14/P60 end of year summary/certificate and form P38(S) student declaration) should be received by your tax office by Monday 19 May. Unless you are hand delivering them, they should be posted no later than Friday 16 May. For those that complete P11D's, the deadline is effectively 4th July.

If you take advantage of the week's grace before penalties for late returns are imposed, remember that 26 May is a bank holiday, so your tax office should receive them by Friday 23 May.

The deadline for giving employees their P60s is 31 May. As that is a Saturday, you should aim for 30 May at the latest.

Investments

The Charity Commission has published the revised version of **CC14** Investment of Charitable Funds. The new guidance includes a definition of investment, which must include an investor providing funds to an investee; therefore gold for resale, works of art and land are still excluded.

The guidance also refers to investments in trading companies. Trustees need to ensure that it is in the charity's interest to make or retain an investment in the company. This is unlikely to be the case if the company is not economically viable with no real prospect of becoming so. Where the investment is not considered to be for the financial benefit of the charity, it can be regarded as 'non-charitable expenditure' by the Inland Revenue and can lead to a restriction of the charity's tax reliefs. One charity has been criticised by the Charity Commission for losing money in a failed business venture whereby it loaned money to a trading subsidiary operating charity shops. The charity was criticised for failing to take independent advice and for making a loan that was insufficiently secured.

Trustees are able to make ethical investments where these provide the best balance of risk and reward for the charity (section 84) but the principle should still be to maximise returns. It is recommended good practice for large charities to include in the investment policy the extent to which social and ethical factors have influenced investment decisions.

Ethical investing can be difficult in pooled funds or Government funds as smaller charities will not be investing sufficiently to be able to exercise control. Views differ among research companies as to whether ethically constrained funds perform as well as the FTSE All-Share Index. However, it is argued that the 'ethical' companies will be sustainable and therefore the best performing in the future. Another factor is the support of donors to the charity. They may feel alienated if they see the charity making an apparent investment in a company at conflict with the charity's objectives. Obviously, the profile of beneficiaries can be of fundamental influence (thus cancer charities would probably not invest in tobacco companies). Trustees however, should bear in mind that their personal moral views should not be used at the expense of the charity's returns. They should have regard for the need for diversification and for expert advice.

The Charity Commission has also updated its model declaration of trust (GD2) and this includes changes introduced by the Trustee Act 2000.



AND FINALLY

BITS 'N' PIECES

Legacies

Beware of properties left to charities in a legacy. There may be restrictions on its use which result in significant outlays for the charity, although there may be some scope for negotiation with the executors and the Charity Commission. There can also be problems if a property cannot be sold immediately, for example vandalism if it is empty and maintenance, council tax, insurance costs etc. If the likely problems seem to outweigh the value, the bequest can always be refused.

VAT

As a result of an ECJ ruling in July 2002, organisations may be able to reclaim VAT previously not allowed by Customs and Excise when the 3-year capping rule was first introduced. Where a claim was previously thought to be out of date, further reclaims for VAT overpaid up to 4 December 1996 can now be made by 30th June 2003. If original documentation is no longer accessible, it may be possible to agree an estimate based on the accounts.

Reserves

The level of a charity's reserves is still a cause for concern in the public domain. It is worth bearing in mind that reserves are not just 'cash'. For charities with a valuable property being used as its premises, we would recommend that this is matched by a designated reserve to highlight that it is not a disposable item.

Tax

FICO (The Financial Intermediaries and Claims Office) is the Inland Revenue office responsible for the tax affairs of all UK charities. Under self-assessment FICO issue corporation tax returns to a sample of charities on a random basis. This must be completed even if all income is exempt and there is no tax to pay. FICO do not require charities' accounts unless they are requested. Even if a charity does not receive a notice to deliver a corporation tax return, the onus remains with the charity to notify chargeability to tax where all or part of its income and gains are not exempt from tax. Penalties will be payable for returns submitted late.



Honoraria

Some charities pay an honorarium for administrative services. We recommend that this is operated through the PAYE system; otherwise the recipient should declare it on their tax return (unless it is covered by their personal allowances). The Inland Revenue rules on whether a person is an employee or self-employed are very complex and the charity would be liable for all PAYE and NIC if the employment status was not dealt with correctly. However, it may be possible to construct a scheme so that the recipient of the honorarium is treated as an office-holder rather than an employee, which might avoid some of the problems of compliance with employment issues. We would recommend that legal advice is sought.

Gift aid

For gifts made on or after 6 April 2003, a taxpayer making a gift aid payment can make an election for it to be treated as made in the previous tax year. The election must be made before the submission of his tax return and in any case by the 31 January filing date. The election has no effect on the charity receiving the gift.

New website for charities

A new website "www.askncvo.org.uk" has been launched to provide 'best practice' help and guidance for the voluntary sector. Areas covered include fundraising, managing finance and general legal issues.

Payments to trustees

This is a very tricky and sensitive area that needs careful research before any payments are made to trustees. It may be argued to be inadvertent but trustees should all be given a copy of the charity's governing document when they join. This is the first place to look to establish if payments to trustees can be authorised (e.g. for professional services). For small amounts, the Charity Commission can authorise payment and it is possible to amend the governing document if a good case can be made for doing so; this must also be approved by the Commission. It could be argued that the use of a trustee for certain work was required due to their specialist skills and the cost would have been higher to use an independent party. For further details see Charity Commission booklet CC11. The Charity Commission website also has 2 useful collective reports entitled 'Unauthorised trustee benefit' which gives practical advice arising from real inquiry cases.

Submission of accounts

Beware of late submission of accounts and annual returns. The Charity Commission have been urged by the Public Accounts Committee to pursue charities filing documents late and has therefore been listing defaulters on its website. Where no satisfactory response has been received, this is also the most common reason for an investigation. A final resort could be fining the charity or trustees and withholding street licences. The Companies House late filing penalty starts at £100 for accounts filed up to 3 months late, gradually rising to £1,000 for accounts over 1 year overdue. Larger charities will be dealt with more strictly and the Charity Commission may report trustees to the police for consideration of prosecution in serious cases of persistent default.

Company law

As already mentioned, the timing of the new Charities Act following the strategy unit report is uncertain. Therefore, we do not recommend that charities delay incorporation until this is law. In any event it should be fairly straightforward to transfer to the new Charitable Incorporated Organisation if this is desirable. And just to confuse the issues even more, the DTI is looking at shaking up company law having published its white paper *Modernising Company Law* last July. Some of the proposed changes are designed to cut red tape for commercial entities but may not be appropriate for charities. For example, the holding of an AGM may be an opt-in rather than being required but in our experience this is often a significant occasion for many charities. Another proposal for companies is a change in the deadline for submission of accounts from 10 months to 7 months after the financial period end. And there is also the possibility of an extension in the audit threshold. These measures could then follow to some extent into the charity sector.

Insurance

Rising insurance premiums have received much press recently. Some of the solutions put forward have been improved risk assessment procedures and security measures. Plans are also being considered for a mutual insurance society just for charities. Under this arrangement, external events are less likely to have a significant impact and premiums should not fluctuate greatly unless there is a large increase in claims.



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