ROTHERHAM TAYLOR
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CHARITY AUDITS AND RELATED ISSUES

YOUR FORWARD
THINKING ADVISERS

THE GENERAL MARKET CONTEXT

In summary

- Huge pressures on finance
- A lack of public and political confidence (both regarding audit and charities)
- Abuse of the structure
- Governance failures
- Hot topics – faith based charities/charitable purpose and outgoings/ donation to cost ratios/executive remuneration/related party transactions

Some background and context for the UK Third Sector

In the words of Charles Dickens in A Tale of Two Cities:

> “It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair.”

The Third Sector is clearly facing enormous challenges at present but at the same time, Captain Tom is thought to have raised around £39 million after tax rebates, having only started with a target of £1,000!

For most UK charities, however, the challenge is balancing the increased demands for services whilst facing limited funding and a depletion of resources, as well as higher than average staff attrition rates and proposed regulatory changes.

But while these challenges still need to be met, the Coronavirus pandemic has almost certainly only served to exacerbate these issues.

> “ A survey completed by the Charities Aid Foundation found that, over this period, 59 per cent of charity leaders said that they had been badly impacted by the scandals, with less than half of respondents believing that charities are trustworthy. ”

With 5,000 new charities being registered a year, there is concern amongst all those in the Third Sector about how, with the amount of funding rapidly decreasing, they will manage to stay afloat. This is particularly the case for smaller charities.

The Voice of Charities Facing COVID-19 Worldwide is based on a survey of more than 500 organisations worldwide, showing to what extent the pandemic is impacting their organisations, and how they are coping with those impacts in their communities. Key findings from the report include:

- 96.5% of respondent organisations have been negatively impacted by the COVID-19 pandemic.
- 67.93% of the respondents have seen a decrease in funding and reported difficulties in reaching donors, while 33.97% indicated an increase in operational costs.
- The main difficulty organisations face in adapting their operations to the current conditions is the lack of infrastructure and access to systems that allow moving their work online. Nearly 10% of organisations surveyed were forced to suspend their work.
- Many organisations have limited staff and cannot rely on volunteers at this time, so the staff they have available are working double the hours to meet their beneficiaries’ needs.
- In fact, more than half of surveyed organisations are unable to fully meet the expectations of those they serve due to staffing limitations and system challenges.

THE AUDIT CONTEXT

What defines a charity?

A charity is an organisation with specific purposes defined in law to be charitable – and is exclusively for public benefit.

Its sole purpose must be charitable. It cannot, for example, also aim to make profit or do something that is not defined as charitable, or provide 'private benefit' to anyone.

Charitable purposes

For the purposes of the law of England and Wales, 'charitable purposes' means purposes which are for the public benefit, and fall within any of the following descriptions of purposes:

- The prevention or relief of poverty;
- The advancement of religion;
- The advancement of education;
- The advancement of health or the saving of lives;
- The advancement of citizenship or community development;
- The advancement of the arts, culture, heritage or science;
- The advancement of amateur sport;
- The advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- The advancement of environmental protection or improvement;
- The relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- The advancement of animal welfare;
- The promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services;
- Any other purposes recognised as charitable under existing charity law, including facilities for recreation or other leisure-time occupation, if the facilities are provided in the interests of social welfare.

Charities are overseen by their boards of trustees. The board of trustees has overall responsibility and accountability for everything the charity does.

Context for audit

Charity

- Not for profit
- Exclusively charitable purposes (Charities Act 2006 stipulates 13 charitable purposes)
- Must benefit the public

Trustees

The Charities Act 1993 defines trustees as:

> “the persons having the general control and management of the administration of a charity.”

Do charities need their accounts audited?

Except for NHS charities, only those charities with gross income of more than £25,000 in their financial year are required to have their accounts independently examined or audited - below that threshold, an external scrutiny of accounts is only needed if it is required by the charity’s governing document.

What is a charity audit?

An audit is the highest level of scrutiny of accounts and the auditor looks for positive evidence to enable the accounts to be described as a “true and fair” view. Every charity with an annual income above £1 million (or with an income over £250,000 and assets above £3.26 million) is required to have an audit.

What is the difference between an audit and an independent review?

An audit report states that reasonable assurance has been obtained that the annual financial statements as a whole are free from material misstatement, while an independent review states that (based on the work performed) nothing has come to the reviewers' attention that causes them to believe that the annual financial statements are not fairly presented.

Exempt charities

These are exempt from registration and many aspects of regulation by the commission. Most exempt charities have their own 'principal regulator'. For example, most universities in England are exempt charities and are now regulated by HEFCE – the Higher Education Funding Council for England. Exempt charities follow the accounting and reporting requirements applicable to their type of organisation (for example, universities follow the HE/FE SORP). Otherwise, the Charities Act only requires them to produce an income and expenditure account and a balance sheet.

These do not have to register with the commission, but in most other respects are regulated by the commission. Examples include charities whose gross income is less than £5,000 per year, churches and chapels of certain religious charities and Scout and Guides groups.

FINANCIAL REPORTING ISSUES TO CONSIDER

Have to report under the following:

- Charities Act 2011
- Charities (Accounts and Reports) Regulations 2008
- Statement of Recommended Practice on Accounting and Reporting by Charities (SORP 2005)
- Financial Reporting Standard for Smaller Entities (FRSSE)

And take into account:

- The Charities Act 2016: this means the Charities (Protection and Social Investment) Act 2016
- The organisation's trust deed
- GDPR etc.

Distinguish and report different fund types:

- Restricted
- Endowments
- Designated
- Unrestricted

It is important that the reader can tell that all the funds are not held on the same basis and it is important that it is clear that certain funds have restrictions on the way the money can be used.

The trustees must also be able to demonstrate that it still holds assets belonging to restricted and endowment funds and has not used these for unauthorised purposes.

It is a breach of trust to spend restricted funds for purposes other than for which they were given without the prior consent of the Charity Commission.

Areas where you may need to take care

It is a breach of trust to spend restricted funds for purposes other than for which they were given without the prior consent of the Charity Commission (may be able to speak to donor).

- Fund-raising activities and purpose/objective (can be too specific or give problem if a surplus is raised)
- Specific trusts with restrictions
- Endowments
- Donations (e.g. for the fabric etc.)
- Lottery offers etc.
- Lottery offers etc.
- Permanent endowment: property of the charity which the trustees may not spend as if it were income. Sometimes it is used in furthering the charity's purposes, sometimes to produce an income for the charity. The trustees cannot normally spend permanent endowment without the commission's authority. The terms of the endowment may permit assets to be sold and reinvested, or may provide that some or all of the assets are retained indefinitely for example a particular building.

Charity regulator criticises quality of audited charity accounts

Only half of charity accounts reviewed by the Charity Commission met the regulator's external scrutiny benchmark with auditors and independent examiners failing to identify significant failings in charity accounts.

The Charity Commission analysed a sample of 296 charities' accounts to see whether they complied with the basic standard of accounting requirements for charities, including around disclosure, quality of accounts and how they accounted for charitable funds.

The research found that one in four charities failed to report related party transactions with the lack of disclosure described as a significant concern, while the regulator criticised trustees for their failure to manage conflicts of interest which were also being widely under-reported.

> "The smallest charities with income below £250,000 were worst at disclosing related party transactions, with 55% of these organisations failing to meet reporting expectations."

The largest charities with revenues over £1 million performed better but still failed to provide full disclosure with 14% of this segment not operating with full transparency.

WHAT IS ‘GOVERNANCE’?

Corporate Governance is:

> “the system by which organisations are directed and controlled and relate to their communities.”

(The Cadbury Report, 1992)

Key responsibilities of Boards of Trustees are to:

- Determine strategic direction
- Provide leadership
- Uphold financial and legal requirements
- Nurture organisation’s values
- Ensure compliance with objects/purpose
- Ensure accountability to all stakeholders
- Ensure sufficient resources
- Ensure assets are managed properly
- Agree the budget and monitor accordingly
- Review the Board’s performance

WHY IS GOVERNANCE IMPORTANT?

20 years of major organisational failure have raised serious questions about the state of corporate governance in the West:

- **Barings Bank** – 1995; Nick Leeson flees Singapore having gambled over £800 million
- **Enron** – 2001; biggest corporate bankruptcy in history at the time; led to break-up of Arthur Andersen (1 of the 5 biggest global accountancy firms)
- **Mid-Staff's NHS Trust** – estimated up to 1,200 unnecessary deaths 2005-08; inquiries – Healthcare Commission 2009 and full Public Inquiry 2013
- **Tesco** – 2014; profits inflated by £250 million+; 8 executives suspended; CEO and Chairman quit; Serious Fraud Office inquiry
- **Sports Direct** – In 2016, a detailed report was released by the Business, Innovation and Skills Committee (ISC) which highlighted the poor working conditions at the warehouses of the retailer.
- **Carillion** – In 2018, Britain's second-largest construction and outsourcing operation, Carillion went into liquidation, after banking on income from large contracts which proved much less lucrative than expected. After its contracts underperformed, its debt soared to £990 million.
- **Kids Company** – In 2015 Kids Company was wound up as insolvent. The charity had received over £46 million in public funding with grants being authorised despite concerns being raised that the funding was not value for money.

Hallmarks of Good Governance:

- Clarity about objects, vision, mission and values
- Efficient structures, policies and procedures
- Clearly identifiable Trustee body, right balance of skills and experiences
- Manages and uses resources to optimise potential
- Accountable in a way that is transparent & understandable
- Flexible enough to influence and adapt to change in the environment

Governance can be thought of as:

"...like being in a helicopter – you need to be able to see the entirety of the organisation and its activity and also what is on the horizon; you also need the ability to swoop down to investigate potential problems, provide additional support and ensure issues are resolved. The skill is knowing when to then soar high and regain the bigger picture!

...governance is not necessarily about doing; it is about ensuring things are done."

WHAT FITS WHERE?

Governance	LEADERSHIP	Management
• Determine mission policy and strategy • Establish and uphold values • Provide representation • Ensure financial viability • Ensure accountability • Provide insight/wisdom to management • Resolve conflicting interests • Manage governance • Appoint/develop Chief Executive • Set risk policy and take legal responsibility		• Develop/deliver mission policy and strategy • Develop and exemplify values • Communicate with stakeholders • Raise resources • Report on performance • Provide information, advice and support to the board • Present options • Support governance • Appoint and develop team • Manage risks and ensure legal compliance

QUALIFYING AS A TRUSTEE

You must be at least 18 years old to be a charity trustee (16 if your charity is a company or charitable incorporated organisation).

Some people are disqualified by law from acting as charity trustees. This normally includes anyone who:

- Has an unspent conviction for an offence involving dishonesty or deception
- Is currently declared bankrupt (or is subject to bankruptcy restrictions or an interim order) or has an individual voluntary arrangement (IVA) with creditors
- Is disqualified from being a company director has previously been removed as a trustee by either the Charity Commission or the High Court due to misconduct or mismanagement

THE ACCOUNTABILITIES OF TRUSTEES

- Accountable to the membership
- Accountable to regulators
- Accountable to the Courts
- Liability for the debts and liabilities of the organisation

THE RESPONSIBILITIES OF TRUSTEES

The duties of the trustees:

- The trustees are the charity trustees and are the 'persons having the general control and management of the administration of the charity' (Charities Act 2011, s177).
- The trustees are entrusted with the charity's funds. They must:
  - Always act responsibly;
  - Ensure that all decisions are taken for the benefit of the charity;
  - Always act in accordance with the governing documents;
  - Not seek personal benefit (commitment to the cause must be the main reason for serving as a trustee).

Trustees are responsible for all charity finance, its management and control, including the appointment of a treasurer. While it may delegate some of its duties, for example, to the management team, this does not remove its legal responsibilities. These include:

- Keeping 'proper accounting records', which include the annual financial statements, and which must be preserved for at least six years from the end of the financial year to which they relate. The records must be sufficient to:
  - Show and explain all the charity's transactions;
  - Disclose the charity's financial position at any time with reasonable accuracy;
  - Enable the required accounts to be prepared;
  - Show on a day-to-day basis all receipts and payments and what they were for;
  - Record all assets and liabilities.
- Ensuring that the finances of the charity are under its control and decision making is only delegated if the trustees can ensure that its wishes will be followed.
- Arranging for a suitable independent examination or audit of the financial statements.
- Preparing the annual report and accounts (financial statements), which must be presented to the Annual Meeting in accordance with the requirements of the Trust Agreement and in most cases to the Charities Commission.

SOME GENERAL ISSUES TO CONSIDER

20 years of major organisational failure have raised serious questions about the state of corporate governance in the West:

- Mission and values
- Insurances and risk assessment/management
- Health and safety – fire, food hygiene etc.
- Children and vulnerable adults
- Social media
- Data protection
- Training

THE NOLAN PRINCIPLES

Everyone who acts as a trustee should uphold the seven principles of public life which were originally set out as the “Nolan Principles”. These are:

Selflessness – trustees have a general duty to act in the best interests of the organisation they serve as a whole rather than to any personal or section interest.

Integrity – trustees should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their role.

Objectivity – in carrying out their role, trustees should ensure that decisions are made solely on merit.

Accountability – trustees are accountable for their decisions and actions to the public, funders and members. They must submit themselves to what scrutiny is appropriate to their role.

Openness – trustees should be as open as possible about their decisions and action that they take. They should give reasons for their decisions and restrict information only when the wider interest or procedure clearly demands.

Honesty – trustees have a duty to declare any interests relating to their trustee role and to take steps to resolve any conflicts that may arise.

Leadership – trustees should have a good working relationship with staff in furthering the organisation’s mission and respect the distinctive role of the incumbent, staff and volunteers in operational management.

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