Charities Technical Digest

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HAT
Group of Accountants

EDITORIAL

Welcome to the latest HAT Charities Technical Digest.

Rising prices in recent months, particularly the cost of energy (consumption of which is always greater during the winter months) has created pressure on finances, with the charitable sector not being immune from these difficulties. The Charity Commission has issued extensive guidance for charities which can assist when it is necessary for trustees to make difficult decisions. Similar guidance in this area has been issued by OSCR. There is also general updated guidance for trustees to provide useful information as to how they can be an effective trustee.

The requirements of the Charities Act 2022 continue to be brought into force, with further enactments expected throughout 2023, by which point, the revised legislation will be fully effective. The Charity Commission is updating its guidance in relevant areas as requirements come into force.

Finally, it should be ensured that the updated HAT Charities Methodology is being utilised for December 2022 year ends. Updated documentation relating to the audit of an Academy will be updated during the summer and should be used for all audits where the end of the reporting period is 31 August 2023.

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MANAGING FINANCIAL DIFFICULTIES IN A CHARITY ARISING FROM COST OF LIVING PRESSURES

The Charity Commission recognises that many charities are facing financial challenges which can have a major effect on charities and those who depend on them. They have issued guidance for trustees, especially trustees of smaller charities, who may need help when facing difficult decisions about their charity's financial position. The following is included in and has been extracted from their guidance:

"Trustees' duties and decision-making:

In these challenging circumstances, it is important that trustees continue to understand and comply with their duties to provide effective financial stewardship, and to ensure that any decisions are in the best interests of the charity and legally sound. As with any trustee decisions, if you are making decisions for your charity to address financial pressures you must:

- Act within your powers under your charity's governing document and the law;
- Act in the best interests of the charity to carry out your charity's purposes, even if the ways of furthering those purposes may need to change;
- Act with prudence to manage your charity's resources responsibly and accountably;
- Act with reasonable care and skill and take appropriate advice when necessary – this is particularly important if the charity or its property may be at risk due to financial challenges; and
- Manage any conflicts of interest.

Acting in your charity's best interests:

Your starting point for trustee decisions must always be what is in the charity's best interests. In the context of financial resilience, the Charity Commission's guidance Charity governance, finance and resilience: 15 questions trustees should ask helps trustees consider what they should focus on. There are likely to be a number of factors to account for, including the balance between:

1. Reducing costs now in order to be able to preserve funds to support beneficiaries in the future; and
2. Meeting the immediate needs of the charity's present beneficiaries with the possibility that in the future the charity will have to reduce its services or close entirely.

Trustees must assess the risks that may arise from the decisions they make. In periods of financial difficulty those risks may include:

- Whether the charity will continue to be able to safeguard beneficiaries and protect them from harm as it goes through potentially significant change; and
- Whether it is prudent to sell investments and other assets in order to release funds for current expenditure. Sales may raise less money than might be secured in better economic circumstances. You should record clear reasons to support the decision. You may also be able to borrow against your charity's assets provided you follow the legal requirements.

We recognise that these decisions will often be difficult, that there may not be an obvious 'right' decision, and that the Commission recognises that things may go wrong despite the best efforts of trustees to act in their charity's best interests.

Evaluating your charity's financial position:

Charities may face shortfalls of income in the current financial climate. If your charity is facing increased pressures, there is a greater need to keep the charity's operations and finances under regular review than would be expected during a more financially secure period. It is important to make sure you have an accurate picture of your charity's current and planned short-term operations, and the cash flow implications.

Robust and frequent reviews of a cashflow forecast will help you manage your finances and evaluate your ongoing ability to carry out your charitable activities. If you believe your charity may not be able to continue operating, read what to do if your charity cannot continue to operate.

What to do if you experience financial difficulties:

Managing a charity's finances covers the considerations and practical steps you can take to identify the options available when your charity faces serious financial difficulties."

There is then a detailed seven part plan which trustees can utilise, which covers the following areas:

1. Minimising costs;
2. Reviewing the charity's funds to see whether any can be released;
3. Conserving or improving sources of income;
4. Addressing financial difficulties in trading subsidiaries;
5. Managing fuel costs: reliefs for charities;
6. Considering the option of mergers or collaborative working; and
7. Seeking external financial support and guidance.

Finally, the Charity Commission highlights that trustees are required to promptly report serious incidents to them. This is not limited to, but may include, issues related to financial pressures and the associated consequences, such as unmanageable debts or reduced income streams.

Guidance from the Charity Commission on 'how to report a serious incident in your charity' will help determine if an incident should be reported.

The Office of the Scottish Charity Regulator ("OSCR") has separately issued guidance on 'how to manage your charity during tough times', which provides a number of links to the Charity Commission's guidance.

ACTION FOR FIRMS
Where you work with charities who are experiencing financial difficulties, make them aware of the support that you can provide.

CHARITY COMMISSION LAUNCHES "5 MINUTE GUIDES" FOR TRUSTEES

The Charity Commission has launched the next stage of its campaign to raise awareness of core trustee duties and the guidance available to charities. Its Press Release states:

"The Commission has developed a collection of short and engaging guidance on issues ranging from safeguarding people to managing conflicts of interest. Dubbed the '5-Minute Guides', the collection serves as a basic toolkit for trustees who are managing the many demands of running a charity.

Research shows that around 98% of trustees feel 'very' or 'somewhat' confident in managing or governing their charity but, when questioned on basic role requirements, on average, trustees answered just 7 out of 10 questions correctly - demonstrating a knowledge gap that could lead to unintentional governance failings. The core suite of 5-minute guides cover the following subject areas:

- Delivering purpose – advice on how to use your charity's governing document, how to deliver on your charity's purposes and the law;
- Managing finances – advice on how to ensure your charity's money is safe, properly used and accounted for;
- Conflicts of interest – advice on how to identify and deal with conflicts of interest in your charity;
- Making decisions – advice on how to make valid trustee decisions that are in your charity's best interests;
- Reporting information – advice on how and what you need to report to the Commission;
- Safeguarding people – advice on your responsibilities to keep everyone who comes into contact with your charity safe from harm; and

» Political activity & campaigning – advice for charities that want to support, or oppose, a change in government policy or the law.

The full collection of 5-minute guides can be found at: Advice and guidance for Charity Trustees – Getting the most out of being a charity trustee."

OVERVIEW OF CHARITIES ACT 2022 PROVISIONS COMING INTO FORCE

The Charities Act 2022 (Commencement No. 1, Consequential and Saving Provision) Regulations 2022 (SI 2022 / 1109) have come into force and, for the requirements of the Charities Act 2022 which apply from autumn 2022, have been confirmed as commencing on 31 October 2022.

As a reminder, the key provisions can be summarised as:

» Paying trustees for providing goods to the charity;

» Making moral or 'ex gratia' payments from charity funds;

» Provisions for fundraising appeals that do not reach, or exceed, your target; and

» Power to amend Royal Charters.

The timing of the remaining key provisions of the Charities Act 2022 becoming effective has not been confirmed, although current expectations, as set out in the Charities Act 2022 Implementation Plan are as follows:

» Changes to how charities sell, lease or transfer land (due to come into effect in spring 2023);

» Greater flexibility to make use of 'permanent endowment' – this is money or property originally meant to be held by a charity forever (due to come into effect in spring 2023); and

» Changes to how charities can amend their governing documents (due to come into effect in autumn 2023).

ACTION FOR FIRMS
Where you work with charities which have been affected by historic restrictions, make them aware that requirements are being relaxed.

CHARITY COMMISSION GUIDANCE ON TRUSTEE EXPENSES AND PAYMENTS

Following enactment of certain requirements of the Charities Act 2022, the Charity Commission has updated their guidance on trustee expenses and payments to clarify the law and good practice where charity trustee boards want to make payments to one or more of the trustees. The Press Release accompanying this update highlights:

"Most trustees are unpaid, but all trustees can claim reasonable out-of-pocket expenses. Charities can also pay some of their trustees (or people and businesses connected to trustees) for goods or services.

A charity trustee may only be paid for serving as a trustee where it:

» Is clearly in the interests of the charity; and

» Provides a significant and clear advantage over all other options.

Any other payment, such as compensating individuals for loss of earnings, needs authority from the charity's governing document, the Charity Commission or the courts. Trustees should have procedures in place to manage conflicts of interest and report on trustee payments in the trustees' annual report and accounts."

UPDATED INVESTMENT GUIDANCE FROM THE CHARITY COMMISSION

A recent High Court judgment (Butler-Sloss and others v Charity Commission) has created uncertainty over whether this has changed trustees' legal duties. The Charity Commission has followed this up with a Press Release, which includes:

"We consider that the judgment offers welcome clarification of how existing legal principles should be interpreted by trustees in a modern context, but that it does not fundamentally alter those principles. We therefore confirm that charities can continue to rely on the legal position in our published guidance Charities and investment matters: a guide for trustees when making investment decisions.

The new judgment confirms that trustees have wide discretion where appropriate to exclude certain investments based on non-financial considerations when making financial investment decisions. These principles are described as ethical investment in our guidance and have also been described as responsible investment.

The judgment also confirms that there is no obligation on trustees to do so – they can, where appropriate, make financial investments designed only to secure the best financial return. The power to invest must therefore be exercised to further the charitable purposes, that is normally achieved by maximising the financial returns on the investments that are made.

We are now progressing a wider redesign of our guidance, which aims to ensure it is easy to follow and enables charity trustees to better understand the law around making financial investments on behalf of their charity. It will also incorporate an updated explanation of social investment, which is distinct from financial investment and is currently covered in separate guidance.

The judgment in detail:

As part of his judgment Mr Justice Green gave the following summary of the law in relation to charity trustees taking into account non-financial considerations when exercising their powers of financial investment:

1. Trustees' powers of investment derive from the trust deeds or governing instruments (if any) and the Trustee Act 2000;
2. Charity trustees' primary and overarching duty is to further the purposes of the trust. The power to invest must therefore be exercised to further the charitable purposes;
3. That is normally achieved by maximising the financial returns on the investments that are made; the standard investment criteria set out in s.4 of the Trustee Act 2000 requires trustees to consider the suitability of the investment and the need for diversification; applying those criteria and taking appropriate advice is so as to produce the best financial return at an appropriate level of risk for the benefit of the charity and its purposes;
4. Social investments or impact or programme-related investments are made using separate powers than the pure power of investment;
5. Where specific investments are prohibited from being made by the trustees under the trust deed or governing instrument, they cannot be made;
6. But where trustees are of the reasonable view that particular investments or classes of investments potentially conflict with the charitable purposes, the trustees have a discretion as to whether to exclude such investments and they should exercise that discretion by reasonably balancing all relevant factors including, in particular, the likelihood and seriousness of the potential conflict and the likelihood and seriousness of any potential financial effect from the exclusion of such investments;
7. In considering the financial effect of making or excluding certain investments, the trustees can take into account the risk of losing support from donors and damage to the reputation of the charity generally and in particular among its beneficiaries;
8. However, trustees need to be careful in relation to making decisions as to investments on purely moral grounds, recognising that among the charity's supporters and beneficiaries there may be differing legitimate moral views on certain issues;

9. Essentially, trustees are required to act honestly, reasonably (with all due care and skill) and responsibly in formulating an appropriate investment policy for the charity that is in the best interests of the charity and its purposes. Where there are difficult decisions to be made involving potential conflicts or reputational damage, the trustees need to exercise good judgment by balancing all relevant factors in particular the extent of the potential conflict against the risk of financial detriment; and
10. If that balancing exercise is properly done and a reasonable and proportionate investment policy is thereby adopted, the trustees have complied with their legal duties in such respect and cannot be criticised, even if the court or other trustees might have come to a different conclusion."

HAT CPD COURSES

To ensure that all members of your team who deal with the preparation and audit of charity financial statements are fully trained, the following are included on the HAT CPD programme. These are:

» Charities Update for Auditors & Independent Examiners (available as a recording); and
» Introduction to Charities ~ A Practical Guide.

Both CPD courses will be scheduled for a future date and can be run, "in-house" at firm's offices on a mutually convenient date. In specialist areas, such as when a firm acts for a charity, during their monitoring visits, audit regulators query how those involved in such assignments have received appropriate training. It is therefore essential that knowledge is kept up to date via appropriate CPD being undertaken.

For details of our charges and availability, please contact Roger Morris at the HAT Office at roger@hatgroup.co.uk.

ACTION FOR FIRMS
With the advent of ISQM (UK) 1, a lack of current training can create quality risks. Avoid such risks by attending our update course.

HAT AUDIT METHODOLOGIES

HAT CHARITIES METHODOLOGY

The HAT Charities Methodology has been updated as part of our annual update cycle.

The key driver of the update is the revision to a number of Auditing Standards, with the following being the areas of most significant change:

» ISA (UK) 315: Identifying and assessing the risks of material misstatement; and
» ISA (UK) 240: The auditor's responsibilities relating to fraud in an audit of financial statements.

The changes to the Auditing Standards are effective for accounting periods commencing on or after 15 December 2021, which are most likely to affect charities with a 31 December 2022 year end and onwards, with care needed for short periods. The updated HAT Charities Methodology has been re-named Charities (January 2022). The HAT Charities Manual (January 2020) should still be used for earlier periods.

There are no changes for Independent Examinations.

ACTION FOR FIRMS
For firms who audit charities, ensure that the current methodology is being utilised for periods commencing from 15 December 2021.

HAT ACADEMIES METHODOLOGY

The HAT Academies Methodology will be updated as part of our annual update cycle. Updated documentation, which should be utilised for accounting periods ending on 31 August 2023, will be issued by this date.

HAT RESPONSE
Time has been set aside early in July 2023 to update the HAT Academies Methodology and this will be released shortly afterwards.

IMPORTANT NOTE

With regards to the technical articles in this newsletter, every care has been taken by HAT in the preparation of these articles, HAT does not guarantee the accuracy or veracity of any information or opinions. No responsibility for loss occasioned to any person acting or refraining from acting as a result of material contained within these articles can be accepted by the editor, HAT, its officers or employees.

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