

"OVERALL AUDIT SERVICE AWARD"

WINNER 2009

Annual Charity Finance survey



charity | briefing

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editorial



Welcome to this edition of our charity briefing in which we have the regular updates on VAT and direct taxes, as well as a guest article from David Haines of MercyCorps on EU fund reporting.

Whilst the last couple of weeks have been eventful in the run up to the Budget, very little emerged. We have however included our not for profit Budget summary with this edition for your information.

The hotly awaited SORP 2010 is also on hold pending further work on the convergence of International Standards on Auditing. Charities can expect to continue following the SORP 2005 for some time yet, although we have been advising clients that we expect the Charity Commission to issue/reissue best practice guidance in areas that the new SORP 2010 would have updated. We have been proved right with the recent reissue of 'CC10 – Hallmarks of a Well Run Charity' where the Commission have increased the emphasis that charities should place on the environmental impacts of decisions and their activities. Watch this space for further developments.

The recent LPO statement on fraud has caught the sector headlines. It continues to be an area of concern that many charities have small finance departments and effective

segregation of duties is often difficult to achieve. BACS is often the cause and is not the 'white knight' it makes itself out to be as it too has inherent control weaknesses. Unfortunately frauds continue to be perpetrated in charities and we would urge Trustees in particular to keep a close eye on this area of activity. We wrote an article on financial due diligence in the Autumn 2008 edition of this briefing and we would refer you back to that article for further information. Do call us if you have any queries.

As we go to press we also draw attention of readers to a technical release issued by the Audit & Assurance Faculty relating to third party grant certification, AAF01/10. Any charity which requires such a certificate should be mindful of this guidance, and we shall produce a summarised update shortly.

Finally an election looms. Charities are often seen as a key knowledge bank for political parties given their extensive experience in key sectors. Charities are reminded to take note of the Commission Guidance on the fine line between lobbying and political activity in the month ahead.

As ever, if you have any feedback on this edition of the Briefing, or wish to discuss any of the matters raised, do contact one of our team.

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VAT update



Apparent developments in charity VAT have been fairly far-reaching recently. There is perhaps the feeling that there is less in these developments than first meets the eye, but care has to be taken not to overlook aspects which are important to your particular charity.

investment management fees

Such fees carry VAT when not generated through sales commissions. Charities with large portfolios could well incur significant VAT in this respect. After much hesitation HMRC has begun to make payments of VAT on such fees where special claims have been made to them. This is on the basis that the investments have a linkage with taxable supplies made by the charity. Of course, that can only be true for VAT registered charities which are indeed making taxable supplies. In theory at least this ought only to apply if the investments support the taxable supplies, which will not always be the case. In any event, only a proportion of the VAT will be recoverable.

In our experience charities have commonly reclaimed VAT on investment management fees on precisely this approach, so the news is of greatest importance to charities that have not done so. If you are in that position you may want to contact us to prepare a claim.

Lennartz goodbyes

With effect from this January charities are no longer able to take advantage of a cash flow saving nick named Lennartz. Those who have used Lennartz before are expected by HMRC to continue to use Lennartz until the expiry of the Lennartz period or else pay back the VAT in one payment.

In a sense, those readers who are not aware of Lennartz cannot now benefit from knowing what it was, but, for completeness, the following is a very abbreviated definition. This related to capital costs and allowed such costs which had both a taxable use and a non-business use to be subject to VAT recovery in full (without apportionment) as long as a deemed VAT charge per VAT return was paid by the charity to recognise the non-business use of the claimed cost. This was calculated by a straight line write off over ten years. No interest was paid, so the financial saving was potentially significant.

A case at the European Court of Justice made it apparent that this rule ought not to apply to charities and that the VAT on the cost ought to be apportioned. HMRC considered this for a long while before changing UK law. It is problematical for HMRC since it has been said in some quarters that charities can receive a windfall because the deemed VAT charge no longer has to be paid. It is clear that HMRC are preparing to challenge that assertion, so it will be interesting to see whether a test case comes along.

hello reverse charge

The New Year also brought a widening of imported services that create a VAT liability by importer charities. These “self accounted” VAT liabilities used not to apply where the purpose was not a business purpose. Now they do as long as the charity is VAT registered. Some services that either did not fall into the reverse charge, or where that point was open to debate, have now been defined as being subject to it. One example that has become widely discussed is fees payable by colleges, universities, and schools to agencies based abroad who “recruit” students for them. Since most colleges etc. are businesses, the impact of the reverse charge can even require the charity to register for VAT where it otherwise would not have to. There may be ways of circumventing that if required, however.

VAT group threat

The EU Commission is unhappy with the UK’s practice of allowing companies which have no commercial activity to become members of a VAT group registration. Although this looks likely to affect passive holding companies of corporate groups the most, some charities might be under threat as well. But the point has yet to grind through to a decision by the European Court, and it seems probable that HMRC will do all it can to defend the status quo. At present, therefore, a watching brief is all that is needed here.

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Gift Aid reform



Following the December release of Government higher rate taxpayer research, February saw the first meeting of the new Gift Aid Forum. The Forum is an informal working group comprising governmental agency and charity sector

representatives, formed to consider operation of the higher rate tax relief attached to Gift Aid. The Forum will not itself make any decisions but is charged with making recommendations for consideration by Government Ministers by 30 September 2010 and will establish specialist sub groups so that the voices of other interested parties from the sector can be heard.

The initial research had raised hopes of a simpler composite rate scheme whereby charities would benefit from the higher rate relief presently enjoyed by the donors. Charities could possibly even access the 20% of all higher rate tax relief "lost" through donors not claiming (due to lack of awareness and/or over-complexity in light of the tax at stake). The hopes for any kind of tax bonanza have been dealt a partial blow by Ian Pearson's clarification that the Government is only interested in tax neutral reforms and that the Treasury is unwilling to make

more money available under the scheme. Given the present economic climate, this should perhaps come as no great surprise to many of those following the reform process and there is, nonetheless, potentially much to be gained from the changes under consideration by way of both increased cash received by charities and simplification.

The idea of higher rate relief going to the charity rather than the donor continues to be debated and it is now becoming clear that the initial assertion that the transfer of higher rate tax relief should not adversely affect donor behaviour does not meet with universal acceptance. More recent research by individual charities indicates that, in some cases, 90% of major donors would reduce their giving if the higher rate relief went to the charity. Some charities with a high proportion of major donors therefore stand to lose significantly if a composite rate is adopted for all donations. Whereas with the more complex method of linking the higher rate tax repayment to the donations from higher rate, taxpayers could result in more modest gains than initially anticipated. The opposite would apply for charities that rely on a large volume of small donations, which would stand to benefit greatly from a composite rate. The results of research has varied and it is therefore questionable as to whether a one size fits all approach covering both small and major donors is appropriate.

iXBRL accounts and other electronic filing



From April 2011, HMRC is making it compulsory for organisations to file company accounts, tax returns and computations in an electronic format called iXBRL – inline eXtensible Business Reporting Language. This will affect all organisations that are

required to file corporation tax returns. It therefore will affect all trading subsidiaries of charities, and any charity that is requested to submit a corporation tax return.

iXBRL is language written specifically for business reporting. It facilitates the electronic exchange of business and financial data, which should allow HMRC to automatically collate and analyse the numbers submitted. The inline version is a format which is designed to be read by people as well as by machines. Essentially the figures included in the iXBRL file are "tagged" so that they can be identified electronically.

The new rules apply for accounting periods ending after 31 March 2010 (filed from 1 April 2011). Charities and their trading

subsidiaries will need to review their systems to ensure they can produce the required iXBRL files. Most tax returns and computations are already prepared by accounting firms using compliant software, however the big issue is the large number of accounts currently prepared in Microsoft Word or other formats.

HMRC are introducing this requirement to reduce processing costs and the easier collection of data. In theory these efficiencies will benefit taxpayers and organisations will benefit from improved online filing. However there will certainly be short-term pain for organisations that need to change the way they prepare their accounts, or require external assistance to prepare them in the required format.

Accounts produced in Microsoft Word or Excel are not currently iXBRL compliant and organisations will now need to determine how they prepare their accounts. HMRC has said that if organisations are unable to submit both corporation tax returns and company accounts in the prescribed format, it will reject the submission, and offenders will be treated as having not filed their returns at all. This could mean penalties and pressure from the authorities to comply.

It has been agreed that the discussions be broadened to include structural and process improvements to Gift Aid, payroll giving and gifts of shares and land. Among the ideas now being circulated for consideration are:

- a **central Gift Aid database** should be introduced so that a donor merely needs to supply their Gift Aid reference number for the charity (or central agency) to reclaim tax.
- **Gift Aid declarations** should no longer be retained indefinitely. It is proposed that these are replaced by a database system, which would possibly be subject to verification only with regards to more recent declarations.
- **sponsorship forms** should no longer require that an address be recorded for small (i.e. < £10) donations and would include a simple tick-box declaration that the sponsor is a taxpayer.
- **online filing** of Gift Aid claims.
- **donations from previous year taxed income** should qualify for Gift Aid.
- **gifts of donated goods** should qualify for Gift Aid regardless of whether a charity has the necessary resources to implement the complex systems needed to “change” the nature of a gift to cash.

- **charity auctions** should be simplified so that there is no need to make “donors” aware of the market value of their purchase.
- **Gift Aid donations of repayments under self-assessment** should be extended and made simpler so that donors can donate to multiple charities by simply writing their names and the amount of the donation on their returns.

Many of these ideas have been around for some time. Whilst some doubt must remain as to whether those that seek to increase the pool of donations qualifying for Gift Aid are likely to be accepted by the Treasury. It may not be possible to achieve reasonable consensus for those that transfer tax savings from the donor to the charity (due to some charities having conflicting needs and donor profiles), and those that seek to simplify the record keeping requirements alone could be of massive benefit. The Treasury has emphasised the need for a focus on simplification and it only remains to be seen whether momentum can be preserved through a general election and a possible change in Government.

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what to do?

If you are currently preparing your accounts on Microsoft Word, Excel or other non iXBRL format, there are three approaches:

- convert your statutory accounts into iXBRL and tag the data. This can be carried out by a number of external consultants; or
- your accountants may have a statutory reporting package that could generate the statutory accounts for you. We are only aware of one financial reporting package that is currently iXBRL compatible; or
- you buy an iXBRL compliant accounts preparation programme yourself.

what about the accounts filed at Companies House?

The ultimate aim is that company accounts will only need to be filed once to satisfy HMRC and Companies House. At present Companies House has decided not to mandate iXBRL filing, although we understand that HMRC are working closely with Companies House, but at present organisations will need to file accounts separately at both.

“Accounts produced in Microsoft Word or Excel are not currently iXBRL compliant and organisations will now need to determine how they prepare their accounts.”

The implication for many charities is that they will require their auditors to use software that is compliant or engage an external consultant to tag the data. Neither are without cost implications and we would advise you to consider this area with your financial advisors sooner rather than later. It is curious that at a time when independence and transparency for external auditors is paramount from the regulators’ and sectors’ point of view that they introduce a series of events that may involve the auditors being required to prepare the final statutory accounts on the charities behalf. Whatever happened to joined up thinking?

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guest article – update for EC projects



A wide range of charities and NGO's, and in particular those that work internationally, bid for and win EC funding to deliver their programmes. Here are a few pointers on key issues that you need to know, and that will allow you to get the most from your EC project.

procurement

Everything that is purchased as part of the project is subject to EC procurement regulations, known as market consultation. The extent of the consultation (from single bid to an open international tender) depends on the value of the contract (not the cost of individual items). In the most recent version of the standard contract, thresholds for consultation and calls for tender were raised:

- single quote for transactions up to €10.000 (instead of €5.000) for service, work and supply contracts;
- 3 quotations for transactions up to €60.000 (instead of €30.000) for supply contracts.

Before the end of the action everything that is bought for the project (including goods and equipment bought with co-financing funds) must be transferred to the local partners or to the final beneficiaries of the action. This handing-over requirement concerns all goods and equipments, but the proof of this transfer must only be included in the final report for items above €5.000.

budget reallocation

It is possible to change the budget, as long as the essential aim of your project remains the same.

You can modify unilaterally the expenditures of a single main budget heading: for instance, if you budgeted one doctor you might replace him/her with two nurses...If the total budget of the heading changes, then the 15% rule applies.

You can transfer a part of the budget from a main budget heading to others as long as this transfer does not exceed 15%. Note that all transfers are cumulative; as soon as you reach the 15% limit, a formal amendment of the contract is required.

The term "main budget headings" should be understood as the main budget headings of the direct costs, i.e. one (human resources), two (travel), three (equipment and supplies), four (local offices), five (other costs, services) and six (other).

budget modifications

It is impossible to forecast accurately for more than about 6 months, and therefore almost all projects require some

modification to both the work plan (log frame) and the budget. In this event, two scenarios should be considered:

- for modifications that are known before the signature of the contract, you should discuss them with the EC (before the contract is signed).
- for modifications needed once the contract is already signed, you should send a request for a contract modification.

In both cases, you are also advised to change/adjust the log frame of the project and send the new version in order to keep the Commission informed about the evolution of the project.

overheads

Every organisation that is UK based, but works overseas, has to cover not only the costs of their international work, but also their overheads in the UK. The EC allows grantees to recover a percentage of the overall budget for this purpose, however, there are very specific rules that govern this.

A maximum of 7% of the total direct eligible costs of the Action can be included in the budget. Example: total direct eligible costs: €100.000 + 7% = €7.000 admin overheads = €107.000 total costs.

The final amount of the admin overheads, which can be claimed depends on the final amount of total direct costs accounted for in the final report and accepted by the EC.

It is important to remember that unlike every other transaction in the project, no supporting documentation is required to justify the 7%.

audit

For a project with a grant of €100.000 or more but less than €750.000, an expenditure verification report of the entire project's account, produced by an external approved auditor has to be submitted, along with the final report.

It is up to the Beneficiary to choose the auditor. The name of the auditor has to be indicated in the contract, in order to enable the EC to make sure that the auditor does not raise problems (they must be members of an internationally recognised supervisory body of statutory auditors).

The Terms of Reference for the expenditure verification report attached to the standard contract as Annex VII are obligatory for all projects governed by this contract version.

Change of auditor may be done through a written notification (not a formal amendment request) to the Contracting Authority (see article 9.2).

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future events

- catholic charities conference 19 may 2010
- employer compliance seminar for schools 27 may 2010
- accounting and legal update seminar series for charities summer 2010
- bursar and governor training september 2010
- training courses for charity trustees autumn and winter 2010/2011

For further information on these events please contact Samantha Cottle on 020 7969 5668, scottle@haysmacintyre.com or visit www.haysmacintyre.com



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