



"Multi award winning charity team"

Annual Charity Finance Survey 2006-2010

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editorial



Welcome to the Winter 2010 edition of charity briefing. It has been an eventful few months in the not for profit world and even as I write, further changes are in the pipeline with the draft Finance Bill 2011.

In this edition we bring you up to speed with fit and proper person requirements, clarifications on VAT partial exemption rules, planning opportunities in the run up to the VAT changes in January and where we are with the internal convergence agenda for accounting standards – a moving feast!

Of particular note is the article on the revised standard on related party transactions – an increase in obligations on the part of Trustees to document not only their own, but also their connected parties (which is widely defined) interests.

In these difficult times, you need specialist advisors who have strength in depth and are recognized for their dedication to the sector. Our partner and manager team below are all charity specialists and are the only team rated amongst the top four firms for both 'Overall Service' and 'Charity Expertise' for the fifth year in a row. If you have VAT, PAYE, accounting, reporting, governance, restructuring or any other need, then do call one of our team and we shall do all we can to assist.

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charity team



are your people fit and proper?



The 2010 Finance Act introduced changes to the definitions of charity and Community Amateur Sports Club Scheme (CASC) as well as a strengthening of the non-charitable expenditure rules for payments to overseas bodies with effect from 8 April 2010.

As a result of these changes, HMRC has introduced greater administrative and reporting requirements and has greater discretionary powers to withdraw tax relief. Whilst it is unlikely that a UK charity that is not engaged in tax avoidance activities would be at risk of losing its entitlement to tax exemption, comments in the press from HMRC have not been comforting. Even if HMRC's new powers are applied sensibly, failure to follow the correct procedures could well result in delayed repayment claims as well as unnecessary and costly disputes.

New legislation was initially made necessary due to the extension of the favourable tax treatment for charities to some bodies established outside the UK. HMRC has taken advantage of the opportunity to introduce additional measures to curtail perceived tax fraud and avoidance activities undertaken through charities.

As well as extending and refining the definition of a charity, the conditions for treating payments to overseas bodies as charitable expenditure have been tightened so that a tax liability is much more likely to arise through inadequate checks on the application of funds being implemented or documented. By far the most contentious issue, however, has been the introduction of the "fit and proper persons" requirement for the managers of a charity. The changes did not initially receive detailed scrutiny as the dissolution of Parliament for the election prevented proper discussion with sector representatives. Following widespread opposition, HMRC guidance has already been watered down and could well be subject to future changes.

The legislation broadly requires that the managers of a charity do not have a history of negligence or dishonesty. Whilst there can be no real objection to the idea that the individuals managing a charity should be suitable for the post, the legislation leaves much open to interpretation. The initial guidance issued by HMRC cast the net much too widely when setting out both the individuals that are considered to be managers and the factors that would lead to an individual being deemed unsuitable. These matters have now been addressed to give more certainty, so that:

- The definition of "managers" no longer includes cheque signatories or a non-specific "catch all" class.

- They are stated to be the Trustees, Directors and officials (of a CASC) and that this would include the chairperson, treasurer, secretary and the rest of the management committee, extending to other employees such as members of the executive board for a larger charity.
- The list of identifying factors no longer includes a "catch all" class.

It is not clear that HMRC is assuming any additional powers to punish genuine wrong doing and it seems to us that the measures simply place more of an administrative burden on innocent charities. Notwithstanding the amendments to the guidance, we are unconvinced that the measures will deter enough dishonest activity to justify the additional administration and tax risks that charities now face. Whilst a case could be made for such a regime for charities that are not required to register with the Charity Commission, it is not helpful that UK charities now need to satisfy the overlapping requirements of two separate UK bodies. Neither is it satisfactory to be dependent on non-statutory guidance that can change at any time and on HMRC adopting a sensible approach to its application of the law.

Be that as it may, it seems that the regime is here to stay and more detailed information on the above, including the administrative requirements, is available on both our website and on our fact sheet CHA 046.

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VAT's up?



With VAT set to increase again to 20% on 4 January 2011 it is worth reviewing the position regarding a change of rate to see if the impact can be mitigated, particularly for those charities which are unable to recover VAT.

1. Where goods have been supplied or services performed prior to the change of rate on 4 January 2011 then VAT should be charged at 17.5%. This rate is mandatory for any VAT invoices issued prior to 4 January 2011 and also for invoices issued after that date, but within 14 days of the goods having been supplied or services performed.
2. For invoices issued at a later date, but which still relate to goods supplied or services performed prior to 4 January 2011, the 17.5% rate can still apply, but this is at the discretion of the supplier, so it would make sense to contact suppliers to ensure first that they are aware of this, and second that they will favourably exercise their discretion.
3. Where work is in progress at 4 January 2011 and will continue beyond that date, you should ask them to invoice separately for the work carried out up until midnight on 3 January 2011 and work to be carried out after that date at the 17.5% and 20% rates respectively.
4. It is also possible, to a limited extent, to obtain the benefit of the old 17.5% rate for work that will be done after 4 January 2011. In order to do this you would either have to make a pre-payment to the supplier prior to the rate change. But, the total value of the

supply you are pre-paying for could not exceed £100,000 and you could not circumvent this by splitting your pre-payment into two or more amounts below the limit. In other words you could make 11 separate pre-payments each of £10,000 to 11 different suppliers and that would be fine, but you could not make two separate pre-payments, one of £60,000 and one of £50,000 to the same supplier.

5. You could also fix the VAT rate at 17.5% if your supplier was to issue you with a full VAT invoice prior to the date of the change for work to be done after it. But, for this to work, then again the amount cannot be for more than £100,000 and again the artificial splitting of the amounts is not permissible. In addition, if you go down this route full payment of the amount shown on the invoice must be due within six months from the date on which the invoice is issued.

A clear disadvantage of this latter route is that the supplier will become liable for the VAT shown on his invoice in the period in which it is issued, so they may be unwilling to assist. It may be possible to agree to pay them only the VAT element of their supply. A downside of making a pre-payment aside from cash flow is that the supplier then has no incentive to complete his or her work accurately and promptly.

6. Obviously the same provisions apply to your own standard-rated sales (the zero and reduced-rates are unaffected), so if you are agreeing contracts for such services which will span the rate-change, you should ensure that they cater for the fact that later stage payments would be subject to the new standard-rate, or that if the agreed amounts are VAT inclusive you factor in the higher rate to your pricing structure.

VAT recovery

Other equally important changes due to come into effect on 1 January 2011 include the widening of the Capital Goods Scheme (CGS) to bring the non business use of CGS items into the Scheme. At present the Scheme deals with adjustments to the VAT reclaimed on items in the Scheme to reflect changes of use of the item in making taxable and exempt supplies, e.g. if an item was used solely for making taxable supplies VAT would have been reclaimed in full. If at any point during the 10 year life of the Scheme the item is used to make exempt supplies, and adjustment is required and a proportion of the VAT originally reclaimed is repayable to HMRC.

From 1 January 2011 the Scheme will also reflect non business use. What is potentially less welcome is that minor adjustments will be ignored. On the face of it this is welcome as it avoids the need to carry out lengthy CGS adjustments which result in only a minor adjustment. But, in order to work out whether an adjustment is minor a charity will still need to recognise an item is in the Scheme, and will need to know what its' original VAT recovery rate was at the time of entry into the Scheme, and its current adjustment percentage.

In addition, if having gone to the trouble of doing this you identify that there is an adjustment due in your favour, it is somewhat unfair if you cannot recover the additional VAT because HMRC deems it to be insignificant.

The clawback (and payback) rules which require an adjustment to be made where VAT has been deducted in anticipation of making a taxable supply, which subsequently does not materialise (and vice versa) are also being amended to

reflect changes of intention as between business and non business use.

Lastly, it will also be possible to get approval for a combined business/non business and partial exemption method. At present only partial exemption methods can be approved, and once approved can only be altered from a prospective date. A business/non business method may be regarded as fair and reasonable by one inspector, but not by another on a subsequent inspection leaving the prospect of a retrospective assessment, rather than just a change for the future. This is a welcome change as it will bring increased certainty for charities, though possibly at the cost of lengthy negotiations with HMRC in obtaining approval.

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"Whilst the increase to 20% will grab the headlines and hit many charities in the pocket, the changes to the rules regarding non business VAT are equally important. The rules regarding VAT recovery are already complex and these changes bring more complexity. "

related parties



The Auditing Practices Board (APB) has revised and redrafted the auditing standards and there are a number of changes to auditing procedures that we as auditors are required to comply with. One of the major changes to our approach which will require more work is the audit of related parties. ISA 550 "Related Parties" requires auditors to focus on three areas:

- identification of previously unidentified or undisclosed related parties or transactions;
- significant related party transactions outside the normal course of business;
- assertions that related party transactions are at arm's length.

ISA 550 requires auditors to list:

- all related parties (even those with no transactions);
- the nature of the relationship;
- the type and purpose of any transactions with related parties.

The standard is much broader in its application than the previous standard and is likely to take additional time to audit. In order to keep additional audit time to a minimum organisations are advised to ask all relevant individuals to complete a template with the information required above in advance of each audit visit.

The following are defined as related parties:

- an individual or entity that controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
- an individual or entity that has an interest in the entity that gives it significant influence over the entity (say shareholdings with more than 20%) or has joint control over the entity;
- an associate or joint venture of the entity;
- Directors and key management personnel of the entity or its parent;
- a close family* member of any individual referred to above;
- an entity that is controlled, jointly controlled or significantly influenced by any individual referred to above; and
- pension scheme for the benefit of employees of the entity, or of any entity referred to above.

** close family is defined as those family members, or members of the same household, who may be expected to influence, or be influenced by, that person in their dealings with the entity. This would normally include a person's spouse, parent, child (adult or minor), brother, sister and the spouse of any of these.*

The requirements are at the entity level so you will need to retain the information not only for the Trustees of the charity, but also any additional Directors of your trading subsidiaries. We recommend that you ask each of the Trustees, Directors and senior management team members to provide this information together with details of their close family.

If you would like any clarification or assistance with the above then please do not hesitate to contact us.

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charity commission – revised guidance



It's been a busy six months for the Charity Commission, which has published five new guidance documents on the following topics:

- Internal Financial Controls (CC8)
- Managing Financial Difficulties and Insolvency (CC12)
- Charity Reserves (CC19)
- Fundraising (CC20)
- Risk Management (CC26)

All of these documents will be of increased relevance to Trustees in the current climate. CC19 and CC20 include changes relating to the adoption of the

Charities Act 2006 but have not been substantively amended from their 2008 editions.

Similarly CC12 and CC26 have not been substantively amended, however following the new Government's announcement of its first round of spending cuts in the June Budget, it is likely that more charities will see reductions in income streams which had previously been seen as reliable. Trustees will therefore need to pay greater heed to forward financial projections and charities' risk models may need to be kept under more frequent review than perhaps has been the case in the past.

CC8 replaces the Commission's guidance on financial controls published in 2003 and includes consideration of the electronic banking processes which have become much more prevalent in the sector over the past 12 months. The mechanics of BACS payment systems differ between

banking providers and the inherent anonymity of the online payment process represents a heightened risk of fraud in comparison with cheque signatures. Charities will therefore need to design their approval and review processes to ensure that they retain appropriate control over electronic payments.

To accompany CC8, the Commission has also drafted a self-assessment checklist for Trustees to use to indicate areas where the financial controls within their charity may be weak.

All of these documents can be found on the Commission's website as follows: http://www.charity-commission.gov.uk/Charity_requirements_guidance/ccpubs3.aspx

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international reporting standards



Readers may have previously been forgiven for thinking that International Financial Reporting Standards (IFRS) for charities were as imminent as the Prozorov sisters' trip to Moscow. However, read on.

The Accounting Standard Board (ASB) has recently proposed a three-tiered structure under which listed entities continue to apply full IFRS along with certain "publicly accountable bodies" which are unlikely to include most charities. "Small entities" will adopt the UK Financial Reporting Standard for Smaller Entities (FRSSE). Entities in the middle will apply a simplified "IFRS for SMEs".

Furthermore, another draft Financial Reporting Exposure Draft (FRED), covering "public benefit entities" is expected. The ASB has also stated it aims to retain the Charities Statement of Recommended Practice (SORP). Most UK charities are "small" so would follow the FRSSE supplemented by an updated SORP. Work on this SORP is apparently ongoing and it is expected to be modular in structure with certain parts only applying to larger charities.

It is not yet clear to what extent the FRED may change charity accounting but differences could include: treatment of mergers, asset valuation and revaluation, impairments, donated and heritage assets; and valuation of donated services.

Two brief examples out of many possible ones:

- charities currently recognise income from donated services at their estimated

value to the charity whereas IFRS would impose a nil valuation. Some charities could therefore see the scale of their numbers reduce considerably.

- IFRS requires assets to be assessed for impairment only on a commercial cash flow basis whereas charities can currently consider service potential i.e. the delivery of the charitable objectives. The former approach would mean large adjustments.

Many charity accounts could be materially affected but all I can sensibly say is don't panic and treat scaremongering with scepticism. Bear in mind also the new framework will apply for periods commencing on or after 1 July 2013.

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future events

trustee training – what every trustee should know	11 january 2011
trustee training – charities and their properties	25 january 2011
annual schools' conference	2 february 2011
trustee training – charities and their people	8 february 2011
trustee training – sector update	15 february 2011
trustee training – what every trustee should know	5 april 2011

For further information on these events please contact Rhona Thomson on 020 7969 5698, rthomson@haysmacintyre.com or visit www.haysmacintyre.com



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