



# *Diploma in Charity Accounting:*

## *Practice - sample script 2*

### 1. POLICY, LAW AND REGULATION

1a.

- i) Describe one development in policy, law or regulation;
- ii) Explain the impact of this development on your client(s); and
- iii) Explain the advice you gave to enable implementation or compliance.

#### **Implementation of SORP 2015 (FRS 102)**

With effect from accounting periods commencing on or after 1<sup>st</sup> January 2015, the 2005 Charity SORP is replaced by the SORP (FRSSE) for smaller charities and the SORP (FRS102) for larger charities. Along with the introduction of FRS 102 this has resulted in significant changes to accounting disclosures and treatments for many of my clients.

One of my clients is a large investment holding charity (assets of £100 million) which uses funds generated to develop schools and educational services. The investment portfolio is complex, including various derivatives, and accounting for this investment portfolio is technical. The client requested assistance with the transition to SORP (FRS 102).

I reviewed FRS 102 and met with a trustee and the chief executive of the charity to advise on the changes that were required to investment reporting under the new regime. These changes included the requirement to carry listed investments at bid-price rather than mid-price. This allowed them to update their investment accounting systems in advance and avoided extensive adjustments at year end. I also advised on the need for holiday pay accruals which allowed timely capture of the relevant information.

This advice was initially given in 2013, as it was relevant to the opening position at 1<sup>st</sup> January 2014. I continued to review developments to the SORP as they were announced and confirmed by email the position on the various disclosure and accounting changes required as they became public.

This included the requirement to disclose total remuneration paid to key management personnel and the requirement under the new SORP to recognise donation income when receipt is 'probable' rather than 'virtually certain'. This gave the client an upfront understanding of what the accounts would look like for 2015 and allowed them to plan accordingly.

The client asked me to prepare a template for their accounts under the new SORP which they could then populate. I reviewed the SORP and the model accounts issued by the Charity Commission in detail and prepared template accounts on a spreadsheet package, updating accounting policies and disclosures. As part of this exercise, I gave detailed advice on the requirements for reporting on a fund-by-fund basis under the new SORP.

I also advised the client on changes to the Trustees' report, to allow them to draft an updated report for 2015. These included additional disclosure of principal risks and uncertainties and how these are mitigated, additional information on reserves and arrangements for setting key management remuneration.

This process allowed my client to meet their statutory requirements with limited strain on management time. It also gave me a better understanding of the new SORP (FRS102) which has helped me to advise other clients who are adopting the SORP.

(Word count 447, excluding question requirements and titles)

## 2. RESOURCE MANAGEMENT

2a.

- i) Describe one issue of resource management at a client;
- ii) Explain how you addressed the issue; and
- iii) Explain how this enabled you to recommend improvements to the client.

### **Staff expenditure, staff travel and credit cards**

A charitable client (annual turnover £2.7 million) was uncertain how to deal with staff expenditure, staff travel and credit cards.

I spoke with the Chief Executive and advised that it was best practice to have detailed and documented policies on staff expenditure. I suggested that the client put in place limits on the level of expenses allowable in order to ensure that maximum resources were retained for charitable purposes and that there was no possibility of reputational or funding issues which might arise from lavish expenditure by employees.

I then reviewed Charity Commission guidance on staff expenditure, HMRC guidance on appropriate scale rates and which expenses could be met or reimbursed without giving rise to tax charges on the employees or the charity. I also reviewed a wide selection of expense policies across other charity clients in order to identify best practice.

Based on this research, I recommended that a formal expenses policy be implemented and that maximum daily rates for expenditure in the UK and overseas should be put in place, and was able to advise on appropriate rates based on experience with other charities.

The wider context was that it was important that staff felt they were fairly treated when travelling away from home in order to maintain staff morale and encourage participation in necessary business travel. This had to be weighed up against the desire to save money when setting scale rates.

I also provided the client with suggested policies and drafted a staff handbook, which the client then implemented.

As part of the review of staff expenses, I suggested that the client obtain an HMRC dispensation and successfully applied to HMRC for a dispensation to avoid any complexities of reporting staff expenditure which might take up finance staff time. I suggested review procedures which would comply with HMRC requirements and also control against fraudulent expense claims. The procedures were implemented by the client.

This review allowed the client to control the level of staff expenses and put in place robust procedures for review, helping the trustees meet their obligations to safeguard charity funds under charity law and Charity Commission requirements.

Through carrying out this work, I developed a better understanding of best practice in this area, which has helped me to give constructive suggestions to other clients, including to audit clients via the audit management letter.

(Word count 390, excluding question requirements and titles)

### 3. MARKETING, FUNDRAISING, INCOME GENERATION AND INCOME DISTRIBUTION FOR PUBLIC BENEFIT

3a.

- i) Describe one marketing, fundraising, income generation or income distribution campaign/strategy undertaken by a client;
- ii) Explain the advice you gave in connection with the campaign; and
- iii) Explain how this benefited the client.

#### **Brand development and related tax issues**

A new charity was established with the intention of obtaining corporate sponsorship and generating a brand which could be exploited commercially to generate funds to support charitable objectives.

The main fundraising strategy was to develop a brand, including a logo and valuable name, and then allow suitable commercial organisations to use this logo and/or associate with the brand in exchange for corporate donations.

I advised the client that there were VAT and tax complexities which they would need to address. After reviewing the relevant tax legislation and HMRC guidance, I advised that they should establish a trading subsidiary company. This would mean that profits generated by exploitation of the brand, which would amount to a trade, could be paid up by Gift Aid to the charity and therefore would not be taxed, avoiding the tax charge which would arise on direct trading by the charity.

I also advised on the VAT treatment, confirming that VAT is normally chargeable where a brand or logo is exploited in this way. The charity CEO questioned whether corporate sponsorship could be obtained without specifically making benefits available to the extent that VAT became chargeable. I explained to the Trustees and CEO that even very small benefits would give rise to a VATable supply and that registering for and charging VAT would allow the fundraisers scope for negotiation with sponsors, letting them make offers of benefits in return for the funding.

It was eventually agreed that this would be worthwhile, as VAT charged would be recoverable for many donors and the freedom it gave to the fundraisers was expected to generate additional income.

This advice benefited the client by giving them certainty on their tax position, preventing them from having to pay direct tax on their trading profits and allowing them to make benefits available to donors in exchange for corporate sponsorship, which increased income. After instigating these arrangements, annual income from corporate sponsors was £385,000, increasing to £870,000 in the following year.

Advising the charity subsidiary to register for VAT and charge that VAT on to sponsors also avoided a situation where VAT would later become payable and, having not been recovered from corporate sponsors, would be a real cost to the charity.

There were ethical and governance issues around initial funding of the trading subsidiary. I reviewed Charity Commission guidance and advised the client on acceptable methods of funding, confirming that interest should be payable on loans to the subsidiary. I advised that the subsidiary should only be established and maintained so long as it was expected to operate in the best interests of the charity and that this must be kept under regular review.

(Word count 442, excluding question requirements and titles)

## 4. STRATEGY AND GOVERNANCE

4a.

- i) Describe one issue of strategy and governance at a client;
- ii) Explain how you addressed the issue; and
- iii) Explain how this benefited the client.

### **Dealing with trustee conflict of interest**

A charity client (annual turnover approximately £2 million) was founded by three individuals. These individuals were initially appointed as trustees at the charity. However, it became clear that two of them were providing services to the charity that could not be obtained from other external candidates and that they needed to be paid for their services if they were to continue devoting the time necessary to meet the charitable objectives. The trustees approached me for advice on how to resolve this problem.

I reviewed the Charity Commission guidance on conflicts of interest and employment of trustees and advised the clients that as they had the ability to make payments to trustees or ex-trustees in their governing documents, they would not need to apply for Charity Commission approval for any payments / employment but that there were a number of steps required to manage the related conflicts of interest.

I advised that the remaining trustees (excluding the two individuals under discussion) needed to consider whether it was in the charity's best interest to employ these individuals in light of the particular skills and experience that they brought that could not be found elsewhere, and eventually vote on the matter. They should document that process and the conclusions reached.

One alternative option was to carry out external recruitment, but it was felt that this would be costly and it was not expected to be successful. I advised that the options for external recruitment and the reasons for pursuing or not pursuing that course of action should be formally discussed at a trustee meeting and the discussion minuted.

Although there was no absolute requirement for these individuals to step down as trustees, my experience with other charities suggested that donors were often uncomfortable with a trustee-employee. I, therefore, advised that it would be sensible for the individuals to resign as trustees before any potential employment as this would reduce the risk of reputational issues.

The charity followed my advice and the individuals stepped down as trustees. After detailed consideration by the remaining trustees, the appointment as employees was approved and these individuals went on to add greatly to the success of the charity.

My advice ensured that the charity complied with Charity Commission guidance and charity law and was able to explain the position to potential donors, ensuring reputation and future income were not compromised by the appointments. At a later date, the Charity Commission enquired into these arrangements and were satisfied that they were appropriately handled.

(Word count 414, excluding question requirements and titles)

## 5. CHARITY ACCOUNTING, AUDITING AND TAXATION

5a.

- i) Describe one significant charity accounting/audit/taxation issue that you have
- ii) encountered at a client;
- iii) Explain how you addressed it; and
- iv) Explain the technical knowledge/skills that you used in doing so.

### Gift Aid

A client (annual turnover of £1 million) which generates funds via donations from the general public and uses them to assist individuals worldwide in disaster zones was unable to obtain Gift Aid refunds from HM Revenue & Customs (HMRC), as there was uncertainty as to whether they met the criteria to qualify as a charity under HMRC's definition.

HMRC opened a detailed tax enquiry into their affairs, focusing on the nature of the charitable gifts in kind provided to beneficiaries, the role of various individuals and trustees within the charity, connections between the charity and suppliers and the processes for tendering for contracts with suppliers.

I reviewed in detail the relevant tax legislation and HMRC guidance relating to requirements that funds be properly expended for charitable purposes, that management be 'fit and proper persons' and the requirement that payments made to overseas organisations only be paid after obtaining appropriate due diligence on those organisations.

I spoke with the client Finance Officer to explain these rules and the significance of the HMRC queries and to advise on the evidence that should be gathered and then presented to HMRC.

I was able to agree with the tax inspector by telephone that the level of documentation initially requested was not proportionate, persuading them to accept a reduced number of documents which made the process less arduous for the client, freeing up finance staff time to spend on other matters.

I then wrote to HMRC on behalf of the charity providing documents and detailed explanations in response to their questions.

After a drawn-out exchange of correspondence, I was able to provide to HMRC the evidence required and the enquiry into the charity's tax return was closed. Following the closure of the enquiry, the charity was able to reclaim Gift Aid of approximately £200,000, which was then available to apply to its charitable purposes.

Dealing with the enquiry involved detailed knowledge of the tax legislation and HMRC tax guidance around payments to overseas organisations and the tax definition of a charity, as well as an understanding of the types of evidence that HMRC usually need to see in order to confirm charitable status.

My experience in dealing with HMRC on a wide range of enquiries into charity tax matters helped me to put together clear and persuasive arguments and obtain a good result for the client.

(Word count 391, excluding question requirements and titles)

## 6. FINANCIAL MANAGEMENT

6a.

- i) Describe one issue of financial management at a client;
- ii) Explain how you addressed the issue; and
- iii) Explain how this enabled you to add value to the client.

### Expenses fraud

An audit client (annual turnover approximately £3.6 million) identified that their chief executive had perpetrated a fraud on the charity, paying for personal expenses on his charity credit card and claiming them as charitable expenditure.

The first action I took was to make the required report of a matter of 'material significance' to the Charity Commission, making full disclosure of what had occurred in line with Commission guidance. This was an important ethical requirement. I also took the necessary steps to comply with money laundering requirements, reporting internally to my Money Laundering Reporting Officer. I advised the chair of the charity finance committee about the trustees' obligation to notify the Commission that a 'serious incident' had occurred.

Following the discovery of this fraud, the trustees asked me to work with the Finance Director to assist him in establishing a new set of internal controls in order to prevent similar problems arising in the future.

I visited the client and spent time with the Finance Director advising on best practice for internal controls around payments, staff credit cards and expenditure, tendering for suppliers, approval of payment invoices and all aspects of the financial system. This was based on Charity Commission guidance and my experience of controls at a range of my other charity and for-profit clients.

I then reviewed the new systems designed by the Finance Director and suggested improvements. The revised systems and controls manual was implemented by the charity.

Finally, I oversaw a review of the implementation of the new systems, designing a programme of testing and briefing a junior colleague who visited the client and carried out the controls testing.

I reviewed the results of the testing and attended a meeting of the trustee finance committee to report on the new system, confirming that it was operating well. This gave the trustees comfort that the financial affairs of the charity were now being properly managed and the likelihood of further fraud was reduced.

This added value to the client by allowing them to report to the Charity Commission that the systems and controls had had a wholesale review, which prevented external review by the Charity Commission. It helped the trustees to fulfil their obligations around safeguarding charity assets and the new systems around tendering for supply contracts reduced costs moving forwards.

These non-audit services potentially presented a threat to audit independence. After consultation with the head of audit services at my firm, I addressed this by ensuring that all decision making on appropriate systems and controls rested firmly with management and that a second partner reviewed the audit file as a safeguard against the threat of self-review. I explained the threats and related safeguards fully to the client.

(Word count 450, excluding question requirements and titles)

## 7. CONCLUSION

Drawing together your responses to questions 1-6 set out three key learning points from your experience, highlighting skills acquired or developed and lessons learnt.

### Learning points

My role in practice has exposed me to a wide range of charity issues. Usually I deal with either trustees or senior management and I have increasingly been able to see things from their perspective, providing advice which reflects charity best practice and good governance.

- a) Assisting my client in dealing with a management fraud has enhanced my professional scepticism when auditing other clients. Exposure to the ways in which this fraud was perpetrated has helped me to identify and focus on key areas of fraud risk for other clients and suggest ways to control those risks.
- b) Dealing with an HMRC tax enquiry into the charitable status of a client has taught me valuable practical lessons about the evidence HMRC expects charities to retain and the checks they require charities to carry out on overseas organisations. This has helped me advise other clients as to what they should do to ensure compliance with HMRC requirements.

This enquiry also developed my negotiating and persuasive skills as I put forward detailed arguments to HMRC to provide evidence that my client existed for genuinely charitable purposes.

- c) Advising on the tax and VAT implications of arrangements for generating trading income increased my technical knowledge of the relevant legislation and HMRC guidance, which is complex. It gave me improved insight into how fundraisers look to generate income for charities. This has allowed me to ensure that my advice to other clients looking to generate corporate donations is practical and sustainable and reflects common practices on the ground.

My work with charities involves technical knowledge of tax legislation, auditing standards and sector-specific accounting, including the charity SORPs. I have faced ethical issues when dealing with potential threats to audit independence and ensuring appropriate reporting of fraud, consulting with colleagues on complex issues.

(Word count 298, excluding question requirements and titles)

**(Total word count 2,832, excluding question requirements and titles)**