

ICAEW

# Fund Accounting – pitfalls and new opportunities

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Now, for tomorrow



# Fund Accounting

We shall cover:

## Basics, Current Practice & Common Errors

- Trust Law and Restricted Funds
- Fund accounting basics
- Total Return Accounting overview
- Common pitfalls
- Breaches of trust – consequences and remedy

## What's new - Charities Act 2022

- What's in it – what's to come
- Failed fundraising
- Spending, borrowing and investing from permanent endowments

## Q&A Session

# **Basics, Current Practice & Common Errors**

**Stuart McKay – Partner, MHA**



# Restricted Fund Definition



*“Funds held on **specific trusts** under **charity law** are classed as restricted funds....*

*The specific trusts establish the **purpose** for which a charity can lawfully use the restricted funds....*

*It is possible that a charity may have several individual restricted funds, each for a particular purpose of the charity”*

SORP 2015

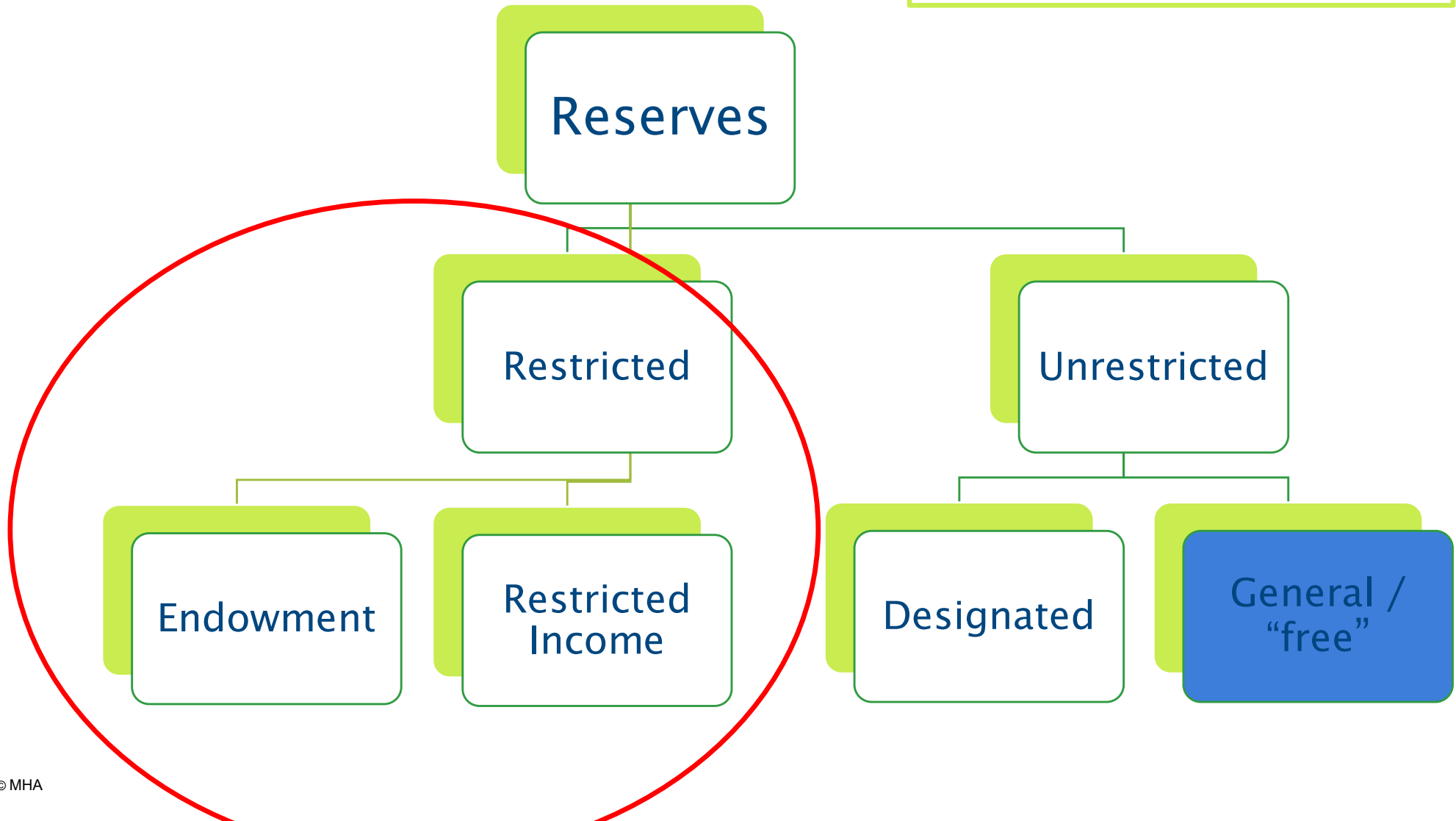
# Reserves structure

## Types of charitable funds



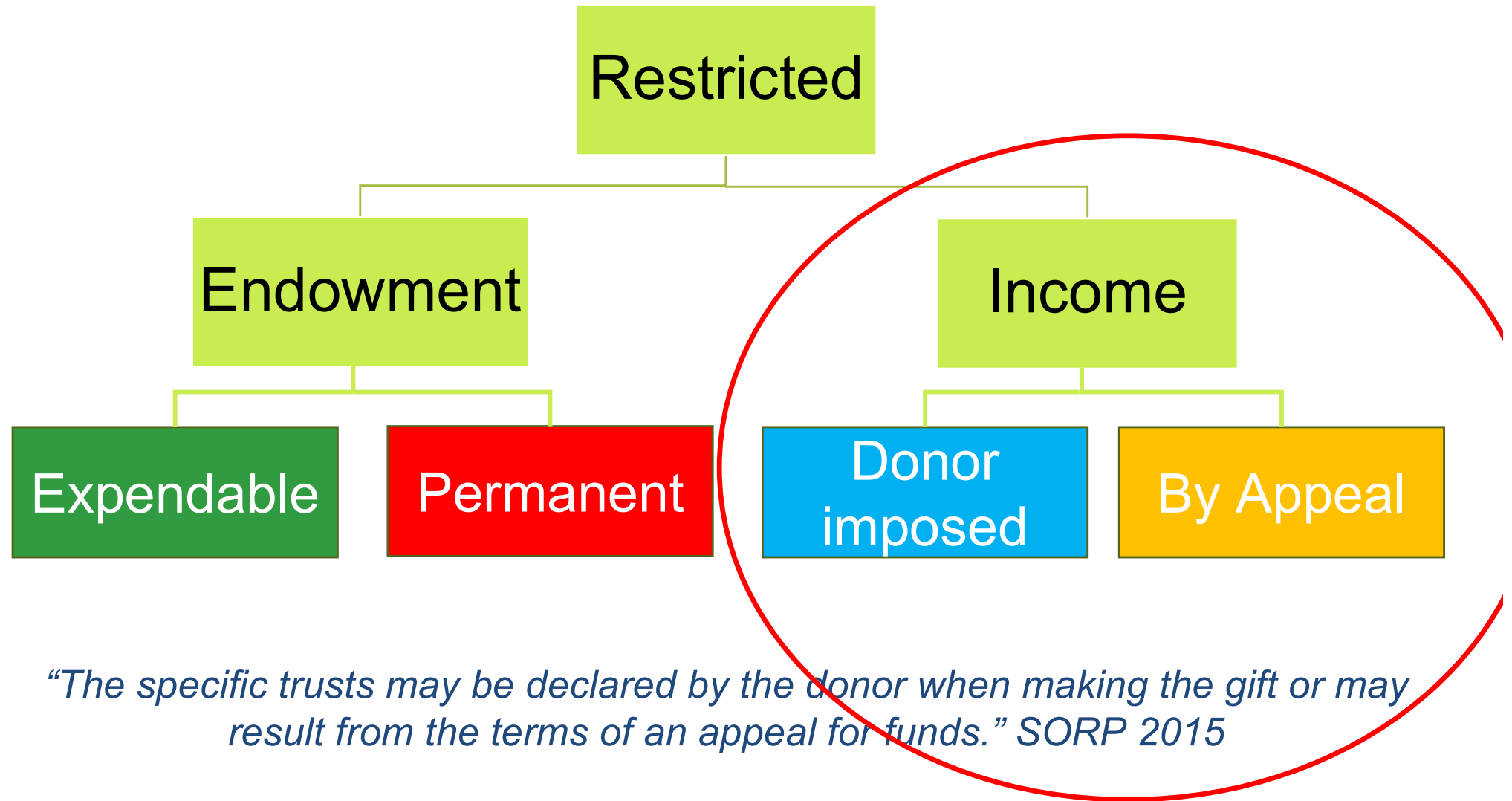
### Key considerations:

- Determined by Trust Law
- Can be complex
- Funds held on trust by the charity



# Reserves structure

Restricted





## Restricted Fund

# Accounting for Income Funds

Restricted income funds must be:

- spent or applied within a **reasonable period** from their receipt
- further a specific purpose of the charity,  
(further **one** or **more** but **not all** of the charity's charitable purposes  
(e.g. narrower than overall objects))

In maintaining the accounting records, charities must:

- separately identify **each** restricted fund and
- Record the income received and expenditure made from **each** restricted fund.



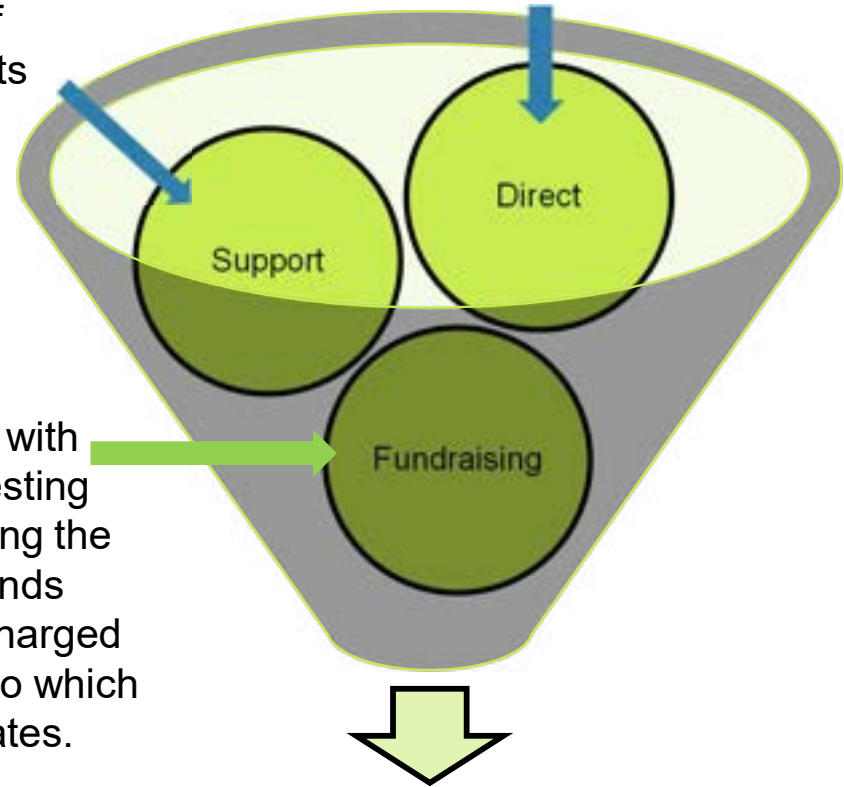
# Restricted Fund

# Expenditure on Restricted Funds

**Directly** attributable to the activities undertaken to further the specific charitable purposes the fund was established to support.

**Reasonable** allocation of support costs

Other costs **associated** with raising, investing and managing the restricted funds should be charged to the fund to which the cost relates.



**Total Expenditure**





# Restricted Fund Accounting

# Common errors

**Negative Funds Carried Forward:** Only go into deficit when there is a realistic expectation that future income will be received to cover the shortfall.

**Insufficient narrative/disclosure:** must provide information on material individual fund balances which includes:

- movements in the reporting period and
  - the purposes for which the funds are held
  - details of the reasons for any material transfers between different classes of funds
- (small funds with similar purposes may be aggregated)

Table 1: Outline summary of fund movements

Fund name	Fund balances brought forward	Income	Expenditure	Transfers	Gains and losses	Fund balances carried forward
	£	£	£	£	£	£
Fund 1						
Fund 2						
Fund 3						
Other funds						
Total funds						



## Restricted Fund Accounting

## Buying Assets

When a **tangible fixed asset** is funded through an appeal or by way of a grant or donation, the accounting treatment of the asset acquired **will depend** on the circumstances of each case.

	Terms of the gift:	Treatment
1	<ul style="list-style-type: none"><li>require the charity to hold the tangible fixed asset acquired on an on-going basis for a <u>specific purpose</u>; or</li></ul>	<b>Continue</b> to hold as a <b>restricted fund</b> and apply depreciation to restricted expenditure going forward
2	<ul style="list-style-type: none"><li>are met once the specified asset is acquired, so allowing the charity to use the asset acquired on an unrestricted basis for any charitable <u>unspecific purpose</u>.</li></ul>	<b>Release</b> the restricted income funds to unrestricted funds via a <b>transfer</b> . Future depreciation is charged to unrestricted funds.
3	<ul style="list-style-type: none"><li>do not require the charity to hold the tangible fixed asset acquired on an on-going basis for a <u>specific purpose</u> but funds would be <u>repayable if the asset was sold in the future</u></li></ul>	Release the restricted income funds to unrestricted funds via a transfer. Future depreciation is charged to unrestricted funds. AND Disclose a <b>contingent liability</b> for the amounts repayable if the asset was sold



# Misuse of transfers

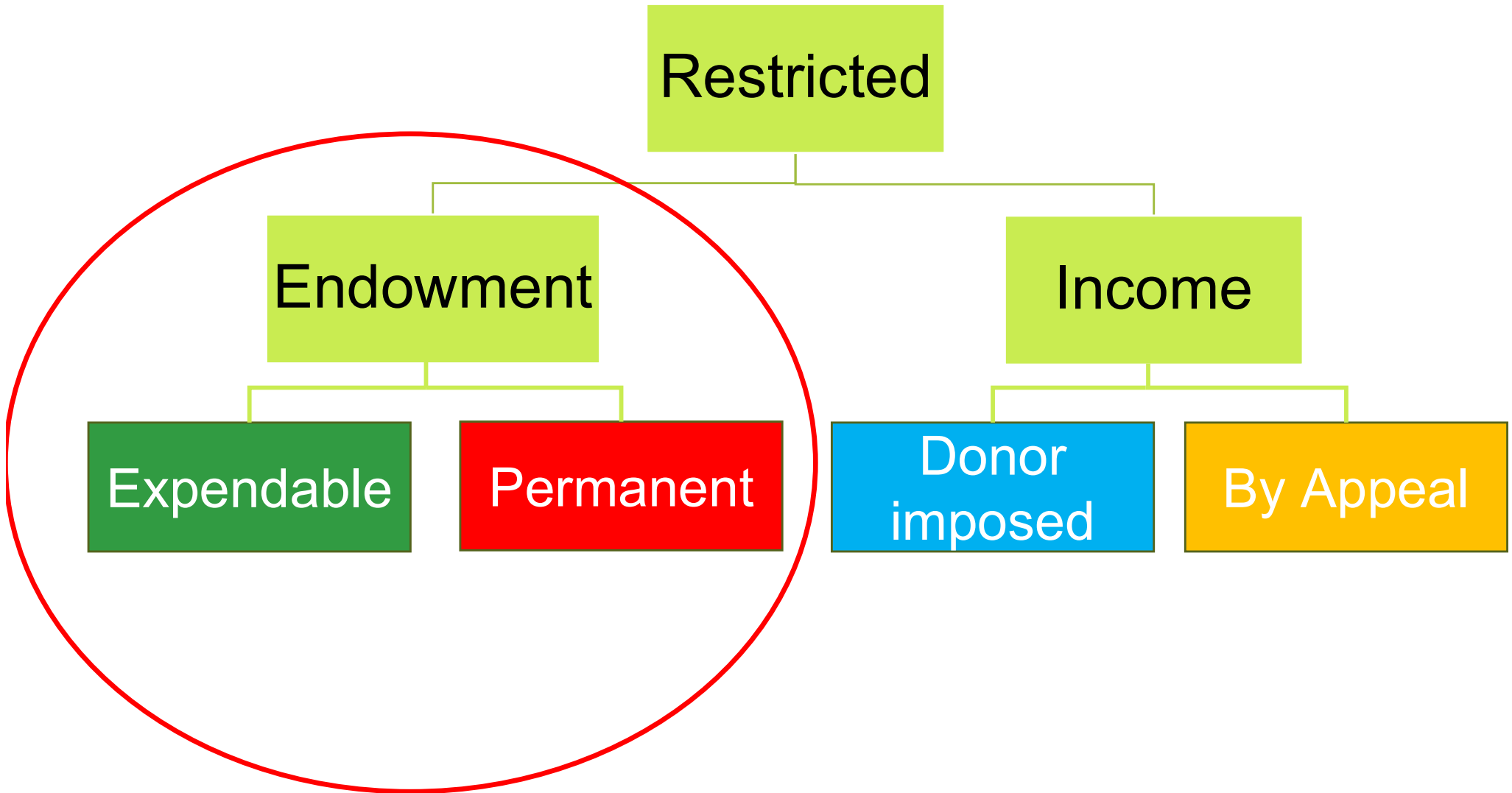
## Restricted Income Fund Accounting

## Common errors II

Can we make a transfer for the following:	
<ul style="list-style-type: none"><li>from unrestricted funds to finance a deficit on a restricted fund</li></ul>	
<ul style="list-style-type: none"><li>to transfer the value of tangible fixed assets from restricted to unrestricted funds when the asset has been purchased from a restricted fund donation but is held for a general and not a restricted purpose</li></ul>	
<ul style="list-style-type: none"><li>for restricted funds have been lawfully released and transferred to unrestricted funds</li></ul>	
<ul style="list-style-type: none"><li>where the trustees have exercised a power to declare a special trust over a gift initially recognised as unrestricted</li></ul>	
<ul style="list-style-type: none"><li>where charity law permits the proceeds of restricted funds to be spent for an alternative purpose (cy-près or failed fundraising)</li></ul>	
<ul style="list-style-type: none"><li>to apply support costs to restricted funds</li></ul>	
<ul style="list-style-type: none"><li>because we wanted to tidy up our fund register</li></ul>	

# Reserves structure

Restricted





# Endowment Funds

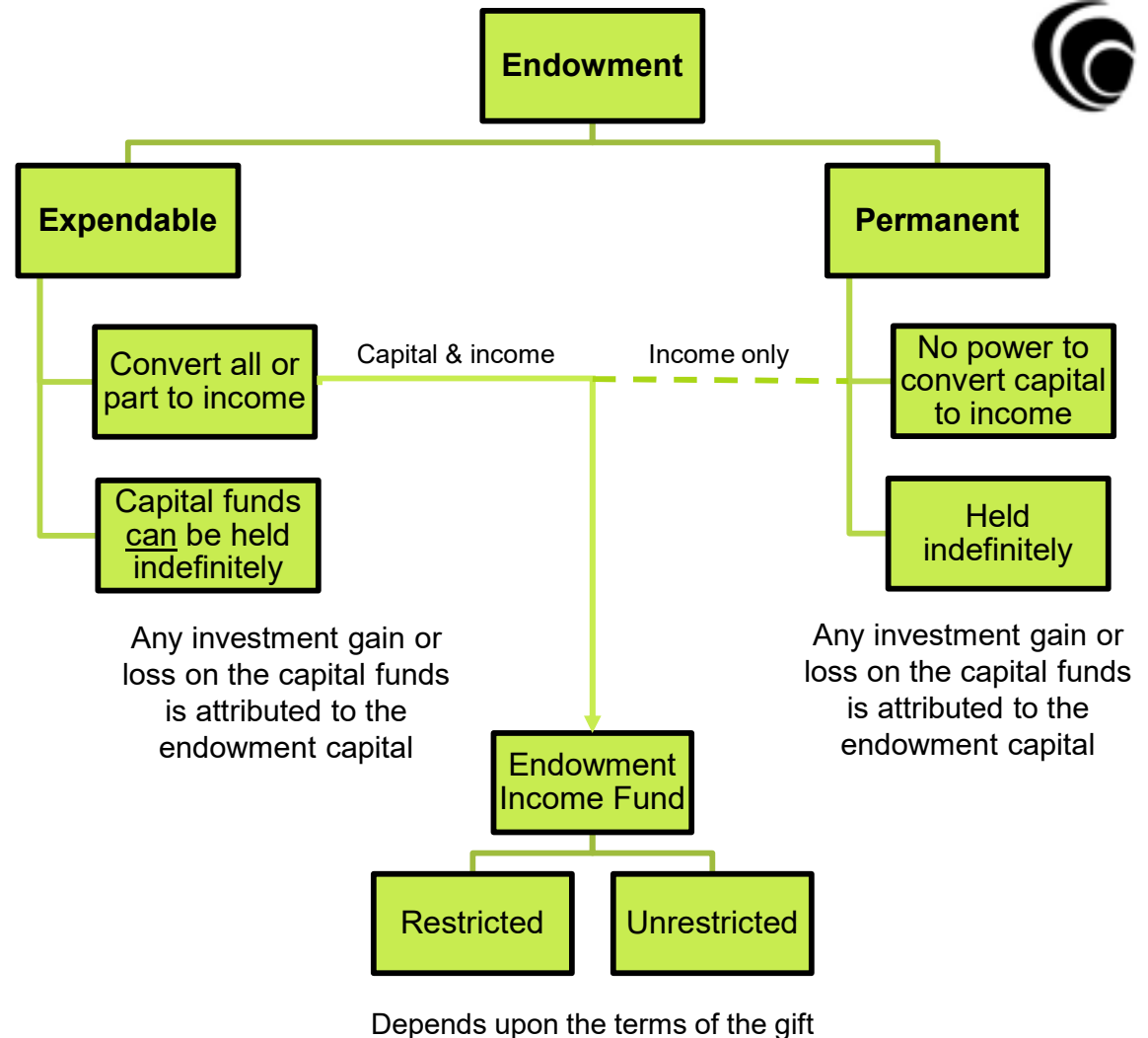
Endowment funds also known as restricted capital funds.

Trust law **requires** a charity to either:

1. Invest the assets of an endowment, or
2. Retain them for the charity's use in furtherance of its charitable purposes,

Rather than apply or spend them as income

# Endowment Funds



Trust law requires both the income (and any investment gain or loss on income funds held) to be allocated to the fund holding the investment e.g. Restricted or Unrestricted funds (Not Endowment Funds).

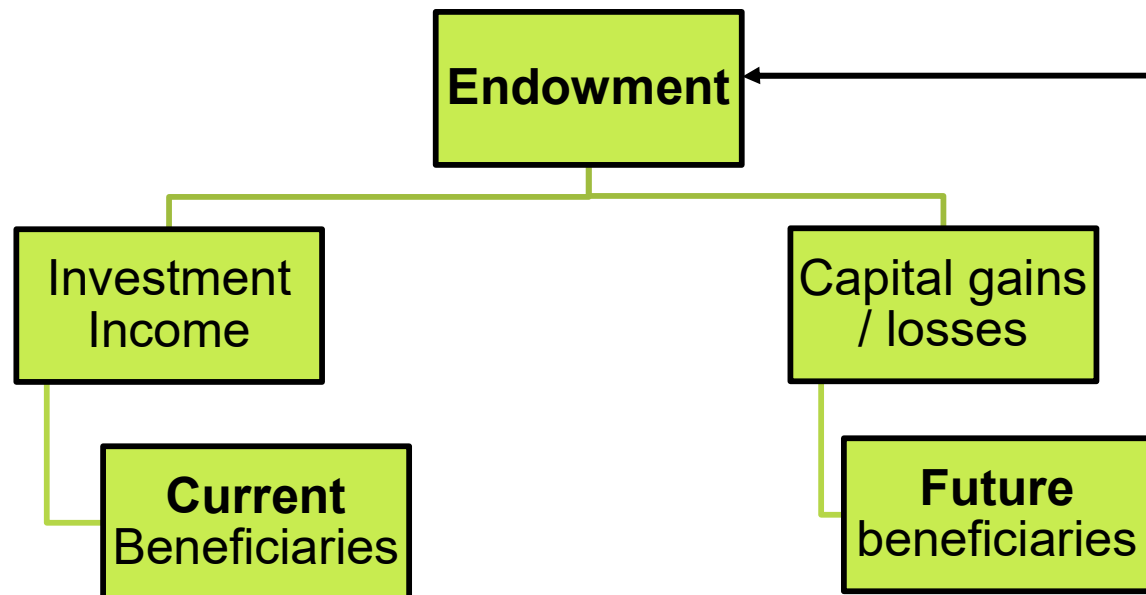


## Endowment Fund Accounting

# Permanent Endowment Funds

Trustees **cannot** add the income from investments to the endowment capital **unless** where they have a power to invest on a total return basis or has the power of accumulation (default power – 21 years).

Standard approach to permanent endowments – fulfilling the requirement to be even-handed between the needs of future and current beneficiaries

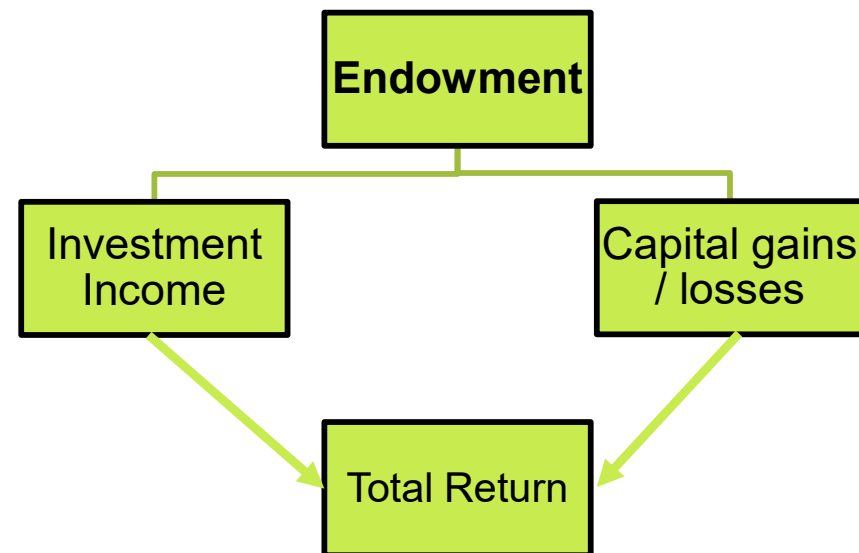




## Endowment Fund Accounting

# Total Return Approach

**Total Return approach** on investment funds for permanent endowment funds



**Investment PE vs Functional PE**

**Charity Commission consent no longer required  
(CA2016)**

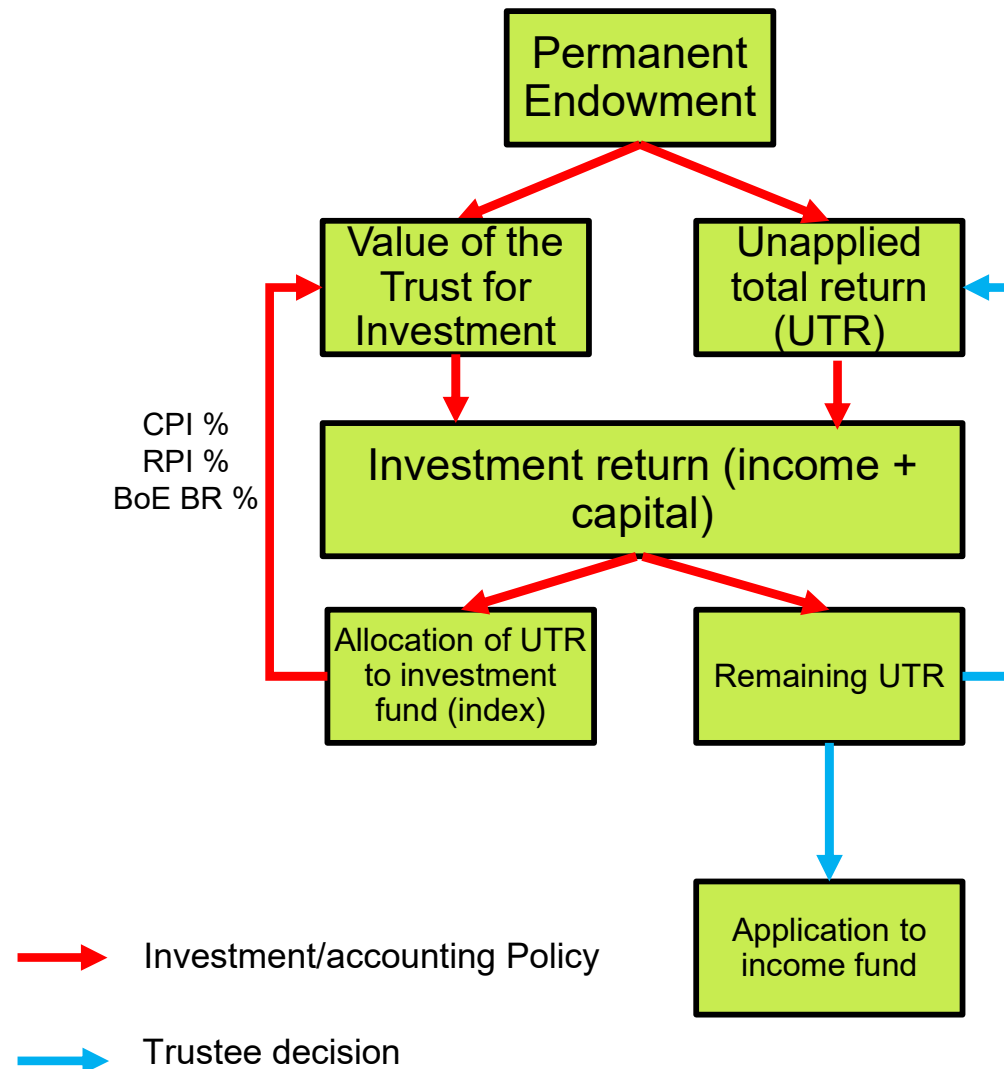




## Total Return approach on investment funds for permanent endowment funds

### Endowment Fund Accounting

### Total Return Approach





## Endowment Fund Accounting

## Total Return Approach

### PRO'S

- Unlocks capital funds
- Gives elements of flexibility to trustees
- Don't have to apply it to all PE funds
- Less susceptible to short term drops in returns
- New ability to borrow from the investment fund

### CON'S

- Complicated regime
- Once applied very difficult to unwind
- Subject to recoupment if the investment fund goes negative
- Justification of the UTR needs additional consideration

**MAKE SURE YOU GET ADVICE AS NEEDED**



## **Common Mistakes**

**Direct mail – unintentionally restricted by appeal**

**Failed fundraising events**

**Far too successful fundraising events**



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# CHARITIES ACT 2022

November 2023

Jonathan Brinsden, Charities Partner, BDB Pitmans LLP

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# CHARITIES ACT 2022

- Royal Assent – February 2022
- “An Act to amend the Charities Act 2011 and the Universities and College Estates Act 1925; and for connected purposes”
- Changes designed to:
  - “significantly improve the efficiency of the sector,
  - release more funds for use on charitable purposes rather than administration, and
  - reduce unnecessary and overly bureaucratic regulation that not only increases the sector’s costs but also is a factor in discouraging people from volunteering to become trustees”



# CHARITIES ACT 2022

- Amends the Charities Act 2011.
- Implementation in various phases:
  - Phase 1: 31 October 2022 - *complete*
  - Phase 2: 14 June 2023 - *complete*
  - Phase 3: *early 2024*
- Ex gratia payments – “under further consideration”

# CURRENTLY IN FORCE

## PHASE 1 (31/10/2022)

- Funds from failed charity fundraising appeals
- Trust corporation status
- Royal Charter corporations
- Payment of charity trustees providing goods
- Amending constitutions of charities established/regulated by statute
- Power of the court and the Charity Commission to make schemes
- Tribunal proceedings – assurance on costs

## PHASE 2 (14/06/2023)

- Permanent endowment – spending and borrowing
- Charity land
  - Reporting and advertising requirements
  - Definition of “connected persons”
  - Exceptions to restrictions on dealing with charity land
- Power to direct charity name change

## STILL TO COME INTO FORCE...

### PHASE 3 (EARLY 2024)

- New power to amend charity constitutions
- Charity trustees (appointment and payment)
- Charity mergers and post-merger gifts
- Charity land:
  - Changes to exceptions from the restrictions on dispositions and mortgages
  - Changes to wording required in instruments
  - Removal of exception for universities and colleges (not until Spring 2025)

### EX GRATIA PAYMENTS

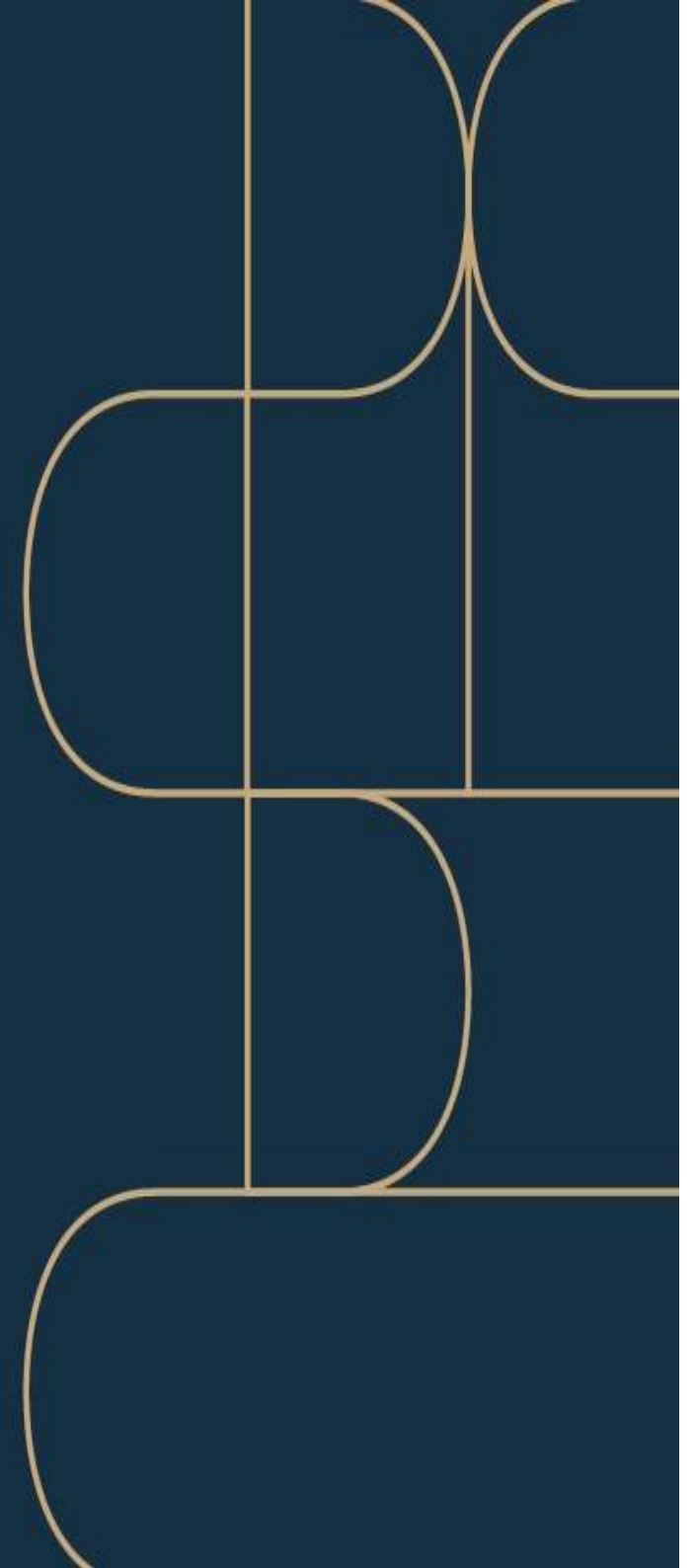
- Small ex gratia payments without prior authority
- If Trustees can “reasonably be regarded” as being under a moral obligation to take action
- Threshold of £20,000 if gross income > £1 million
- “Under further consideration prior to commencement”





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# FUNDRAISING APPEALS



# FAILED APPEALS

- The appeal made *more money* than required to deliver the stated aim of the appeal.
- The appeal *did not raise enough money* to deliver the stated aim of the appeal.

## Previous law

- Made more: apply to the Commission for a cy-près scheme to use the funds for other charitable purposes.
- Not enough: return the funds to donors, unless an exception could be relied upon (eg advertising not identifying donor; the donor had disclaimed; not reasonable)

## FAILED APPEALS – CA 22 RELAXATIONS

- If donor has given £120 or less in a financial year (whether by a single donation or cumulatively over the year), (section 63A(3) and (7));
- Agree with the Commission the reasonable steps to identify donors and, having followed those steps, has not identified or found a donor (section 63A(4) and (5));
- Funds raised from a cash collection or from a lottery or something similar can be applied cy-près where it is not possible to identify individual donors (section 63A(6));
- Where the Commission thinks it would be unreasonable to take steps to contact the donors because it would be administratively expensive or disproportionate or it would be unreasonable for the donors to expect the donation to be returned ((section 63A(1)(a) and (2)).

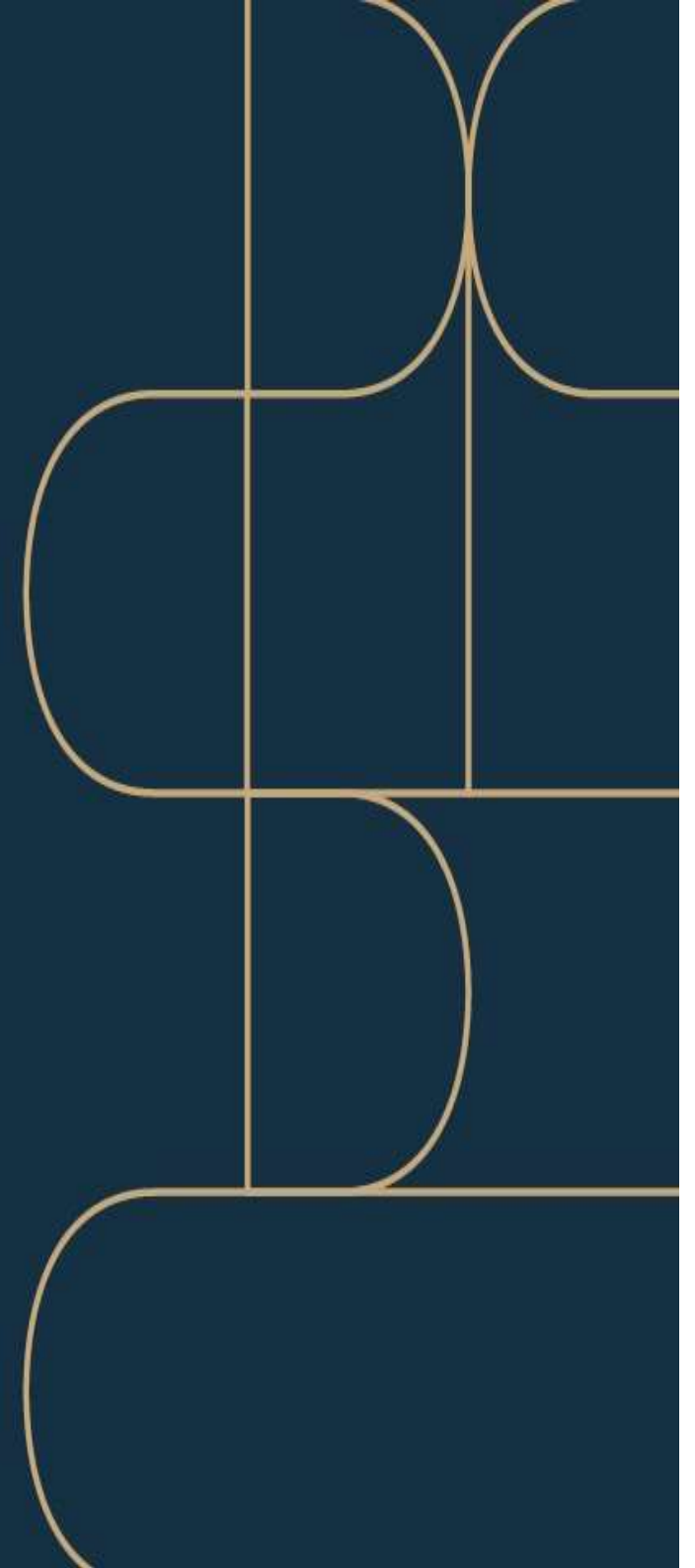
## FAILED APPEALS – CY-PRÈS

- If less than £1,000, no Commission consent is required, BUT Trustees must still have regard i) to whether the new purpose is similar to the charitable purpose for which the money was given and ii) that the new purpose is appropriate in the light of prevailing social and economic circumstances.
- Commission consent is required if it is over £1,000 and the resolution takes effect when the Commission has given its written consent to it (section 67A(3) and (4)).



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# PERMANENT ENDOWMENT



# PERMANENT ENDOWMENT

- Revised definition of “permanent endowment” for Act
- Simplification of powers to release restrictions on spending capital
- New power to borrow from permanent endowment
- New limited power to use permanent endowment to make social investments



# PERMANENT ENDOWMENT – WHAT IS IT

- **“Investment Permanent Endowment”** – cannot sell those investments to spend on the activities of the Charity;
- **“Functional Permanent Endowment”** – real property that can only be used by the Charity to fulfil its charitable purposes eg village hall.

Charities Act 2022 concerned only with Investment Permanent Endowment.

- Other PE features: will be held on trust / a corporate entity cannot hold the Permanent Endowment beneficially / will be treated as a separate charity by the Charity Commission.

# PERMANENT ENDOWMENT DEFINITION (FOR ACT)

Current definition (s353):

A charity is to be treated for the purposes of this Act as having a permanent endowment unless all property held for the purposes of the charity may be expended for those purposes without distinction between

(a) capital, and

(b) income;

and in this Act “permanent endowment” means, in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity

ChA 2022 definition:

For the purposes of this Act, property is “permanent endowment” if it is subject to a restriction on being expended which distinguishes between income and capital

As currently, only applies for purposes of the Act



## PE - POWER TO SPEND CAPITAL – OLD LAW

- Release the restrictions on spending permanent endowment, without consent provided:
  - trustees satisfied that the purpose of the trusts could be carried out more effectively if the capital could be spent; AND
  - annual income of the charity did not exceed £1,000; OR
  - value of the endowment fund did not exceed £10,000
- Otherwise Commission consent needed

## PE - POWER TO SPEND CAPITAL – SS281-282

- Clarifies - power available to corporate charities holding PE
- Trigger for Charity Commission oversight:
  - simplified to where fund value exceeds £25k (adjusted if fund borrowed from)
  - £25k amount can be amended by regs
- Obtaining CC consent:
  - Time limit for CC to respond - reduced from 3 months to 60 days to align with other time limits in the Act
  - As now, time period may be extended for compliance with any CC requirements to give public notice or provide information
- Borrowing from fund – adjustments made to integrate power to spend with power(s) to borrow + obligation to repay

## NEW POWER TO BORROW FROM PE (NEW S284A-D) -

- “New statutory power:
  - in addition to any express power
  - can be restricted or excluded by the trusts of the charity
- Can use the borrowed money for any of the Charity’s purposes;
- Limited to “Investment Permanent Endowment”
- Must be “expedient in the best interests of the Charity” to borrow AND arrangements in place for the amount to be repaid within the 20 years

## NEW POWER TO BORROW FROM PE - LIMITATIONS

- Maximum of 25% of the value of a Charity's Permanent Endowment can be borrowed
- The repayment period must be no longer than 20 years;
- Charity Trustees can “elect” to pay more than they borrowed;
- Trustees required to exercise the power in line with their existing duty of even handedness;
- Trustees should be satisfied that arrangements are in place for the amount to be repaid within 20 years;
- Trustees would need to seek directions from the Commission if it appears that they will not be able to repay the borrowed amount.
- Borrowing in excess of 25% requires Charity Commission Consent under existing powers (Section 105 CA 2011).

## NEW POWER TO BORROW FROM PE - OVERSIGHT

- No specific enforcement mechanisms or supervisory regime in respect of this new borrowing power,
- Trustees can borrow and spend the money all without reference to the Charity Commission.
- Trustees will be required to have a repayment plan in place.
- Trustees will need to account for their progress in accounts
- Envisage the Charity SORP being updated to reflect repayment plan and ongoing compliance with it.
- If Trustees cant repay?
  - Order from the Commission (see new Operational Guidance)
  - Statutory powers to spend Permanent Endowment (under Section 21 and 282) have been extended to alleviate from the obligation to repay the outstanding amount

# TOTAL RETURN INVESTMENT - PE AND SOCIAL INVESTMENTS - S104AA

- Generally, trustees cannot invest PE in social investments with an anticipated negative financial return (where the trustees expect to receive back less than the initial capital outlay), because it would contravene the restriction on expenditure of capital
- The Act introduces a new power, where a s104A resolution is already in place in relation to a PE fund (i.e. to invest on a total return basis), to resolve that:
  - the fund or a portion of it, and
  - any returns from the investment of the fund or portion
    - may be used make social investments that the trustees could not otherwise make (i.e. because they are expected to make a loss)
- New regulations will also be made to govern the use of the power for such funds (s104B)



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An aerial photograph of a large, forested island in the center of a turquoise body of water. The island is surrounded by smaller, scattered forested islets. The water is clear, showing some shadows and textures. A black rectangular box is overlaid in the center of the image, containing white and green text. A small green horizontal bar is positioned above the text box.

Thank you for listening  
**Any Questions?**