Deloitte.

Investments
Surveying investment in the charity sector

Contents

Foreword

This is our first annual survey of investments in the charity sector. There are a number of reasons behind our intention to carry out this survey.

One reason for the survey is to produce a benchmark guide for charities so as to enable them to compare themselves against their peers. The other reason, however, is that investments have taken a significantly more prominent place in charities; partly due to external economic factors and partly due to increased dependency of a number of charities on their investment income.

With the new Charities SORP being developed, investments are to take an even more prominent place in reporting by charities.

As with any survey please note that the results are based on a sample and therefore should be treated with care.

Treat investments with care and ensure you take professional advice at every step.

Reza Motazedi
National Head of Charities and Not for Profit Group
Deloitte LLP

Section 1 – Executive summary

Are your investments working for you? It is the duty of trustees to make the best use of resources within their acceptable risk tolerance, but this may not always mean safety first. Whilst liquidity and cash security is perceived as key for many charities, investments which account for almost 45% of reserves held by charities can do more. Some charities are beginning to push the boundaries with bonds and other social investments. Making the best use of resources involves not just the incoming resources of the year but a holistic view of the charity's reserves, investments and future objectives.

Not all investments need to be financial investments. Investments can range from the traditional cash, stocks and shares, to loans given to support other charities whose activities directly further the lending charity's aims. Each investment should be made for a purpose to support the activities of the charity. These objectives may range from: creating an income out of which charitable expenditure can be made; achieving the charitable aim through the investment itself; financial security; or liquidity aims. Whilst the trustees' obligation is to make investments in the best interests of the charity within its governing documents, the definition of best interests to the charity ought to be debated and agreed by the trustees. The purpose of this survey is not to give investment advice, but to analyse the various practices within the sector and provide points for challenge and discussion.

The Charity Commission guidance[1] makes clear that all investment decisions ranging from cash to programme related investments are valid forms of investment at the discretion of the trustees, but that each should be supported by a policy which reflects the risk attitude and decisions of the trustees as to the purpose of each investment and how it will be used to further the charity's aims.

A research report into social investment[2] was commissioned by the Charity Commission and reported in March 2013. The study suggests that the most serious barrier to social investment is the lack of understanding between investors, investees and charities (who could be either investors or investees).

Deloitte's review of investments looks at the annual reports of 100 charities to understand the types of investments that are being made and the explanations given in the annual reports regarding investment policies.

The survey found that over the charities sampled there were few (10%) with programme related investments and even fewer (3%) where investment had been made in the charity through a loan, bond or other financial assistance. Cash balances, on balance sheet and within investment portfolios, were relatively high with cash accounting for just over 8% of gross assets held by the charities sampled and about a fifth of the investment portfolio.

An investment policy of some description was included in 74% of accounts and the investment objectives were described in 64%. However, the performance against those objectives was reported clearly in only 14% of accounts with a further 33% providing some discussion of performance but not in the context of objectives and therefore achievements.

1 *Charities and Investment Matters: A guide for trustees* (CC14)

2 Charities and social investment – A research report for the Charity Commission published by the Institute for Voluntary Action Research in March 2013

There is no 'one size fits all' answer to any charity question and particularly not in relation to investments and the variety of practices, investments and objectives are clear from the survey. However, each trustee will need to assure themselves that they understand not only the reasons behind their investment choices but also the contribution that each one makes and the impact on the profile and results of the charity.

As trustees' annual reports continue to develop, and more attention is placed in the corporate world on integrated reporting, understanding the impact of a charity's investments and reserves will be demanded. The idea of the social investor and social investment will become common place in the corporate and charity world and at this stage it is for charities to lead the way.

We have structured this survey to review both compliance with investment reporting requirements and the investments held. We have provided appendices on financial investments, social investment, the reporting requirements and the legal framework for investments.

If you would like more detailed information or are seeking advice on specific investment models or the application of the principles of the Charities SORP, please contact Reza Motazedi (rmotazedi@deloitte.co.uk or 020 7007 7646) or any of the contacts listed in Appendix 5.

Section 2 – Investment framework

This section summarises the framework for managing and reporting investments applicable to charities subject to statutory audit in the United Kingdom.

A charity's trustees have a general power to invest in the best interests of the charity and within any framework or rules laid out in the governing document. This framework provides scope to charity trustees to make decisions balancing risk and reward.

The Charity Commission published comprehensive guidance, *Charities and Investment Matters: A guide for trustees* (CC14)[3] which makes it clear that in order to act within the law, trustees must:

- Know, and act within, their charity's powers to invest;
- Exercise care and skill when making investment decisions;
- Select investments that are right for their charity, including the suitability of and the need to diversify investments;
- Take advice from someone experienced in investment matters unless they have good reason for not doing so;
- Follow certain legal requirements if they are going to use someone to manage investments on their behalf;
- Review investments from time to time; and
- Explain their investment policy (if they have one) in the trustees' annual report.

Investment can be approached in two directions and it is important to consider both investment by charities and investment in charities. More consideration has typically been given to investment by charities although the social investment report of March 2013, discussed in section 1, suggests that whilst there are barriers to social investment, investment in charitable enterprises is expanding rapidly.

Investment by charities

There are two main categories of investment commonly made by charities:

1. financial investment; and

2. programme related investment.

Financial investments can be further broken down to include ethical and mission connected investment. The duty of trustees with regard to financial investments[4] is to seek a maximum financial return consistent with the level of acceptable risk. Appendix 1 includes further insights on financial investment decisions.

Programme related investments are funds used for the furtherance of the charitable purpose which may also give rise to a financial return but must be justified in terms of whether the decision to use the funds in this way was a reasonable way to further the charity's objectives.

Investment in charities

Social investment, that is investment in social enterprises, is an expanding but young market. The government established Big Society Capital in 2012 to push significant funding into the market through intermediaries and the number of intermediaries or organisations prepared to source finance to social enterprises are also expanding.

A social enterprise has no legal definition but encompasses the concept of a viable trading business with social aims that reinvests its profits. Although a social enterprise need not be a charity and can be established and run through many legal forms, in many cases a charity fits neatly within that description.

Social investors are looking for both a return and an impact.

3 A legal underpinning Charities and Investment Matters (CC14) was also published to accompany the guide with more information about the case law supporting some of the guidance

4 Within the power of investment referred to in the Trustee Act 2000

The Charity Commission report on social investment[5] states that charities must be sure that they are clear with investors regarding their unique charitable status characteristics and that trustees must fully understand their responsibilities.

- If making a programme related investment, charity trustees must ensure that the investment directly furthers the charity's aims.
- Any private benefit arising from charitable investment must be carefully considered and assessed by trustees.
- Charities cannot distribute profits and there are strict rules surrounding the payment of interest on share capital.

Appendix 2 gives more detail on the types of funding available to charities and social investment bonds.

Investment reporting

The SORP[6] lays out the requirements for reporting and disclosing investments and investment policies which are summarised in Appendix 3. It is important to note that having an investment policy can apply equally to all charities whether they are investing in property, stocks and shares or merely holding cash deposits. Making a decision not to invest or to maintain assets in a very liquid form is as much of an investment policy as investing in a portfolio and should be explained in the context of the charity's activities and attitude to risk.

Future accounting and reporting developments

Social investment, Programme Related Investment, the use of loans and mixed motive investment remains unconventional and in many cases ground breaking. Lord Hodgson touches on social investment in his report[7] commenting that until recently (2005) such a thing was unheard of as it has been deemed primarily the responsibility of trustees to generate a return from investments that they could then use for their charitable purposes: any outlay primarily intended to deliver a social benefit was therefore part of the charity's spending on achieving its purposes rather than an 'investment'. Lord Hodgson notes the Charity Commission guidance (CC14) as welcome but that it does not have the force of statute law.

Therefore his report identifies a number of barriers to social investment. These include:

- Lack of distinct legal forms;
- Uncertainty over investments' tax status;
- Uncertainty over due diligence, process and establishment costs; and
- Uncertainty over how to value such investments.

Lord Hodgson's report identified a number of recommendations to increase clarity and promote social investment, which include:

- Amend the Trustee Act 2000 to draw attention to the distinct responsibility placed on charitable trusts to further charitable purposes as opposed to private trusts that must simply preserve capital;
- Develop a standard social investment vehicle to allow funding from different sources to be invested, and maintained separately (reflecting tax and other requirements), in the same product;
- Re-word the requirement around private benefit from 'necessary and incidental' to 'necessary and proportionate';
- Develop a standard system for valuing social investment; and
- HMRC should provide clear guidance on the tax treatment of different types of social investment.

We wait to see if and when any of the above recommendations are acted on.

5 http://www.charitycommission.gov.uk/about-the-commission/our-research/research-reports/charities-and-social-investment-analysis/

6 Accounting reporting by charities: Statement of Recommended Practice (revised 2005)

7 Lord Hodgson's review published in July 2012 *'Trusted and independent: giving charity back to charities – review of the Charities Act 2006'*

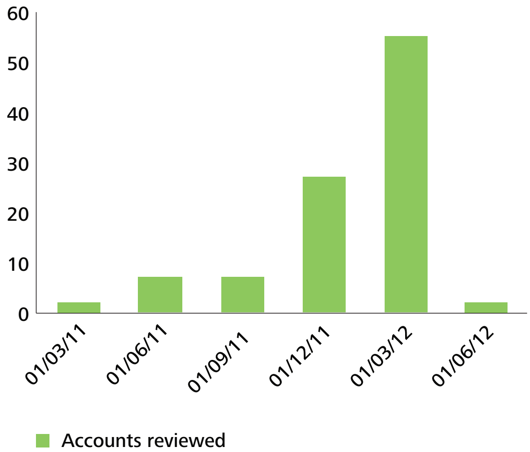
Section 3 – The survey's objectives and basis

The main objective of the survey was to consider the quality of investment information presented in the annual reports of a sample of charities and how that information compares across the sector.

In addition, we have considered the varying types of investment held, investment managers' fees (where disclosed) and portfolio information which will enable us over a period of time to develop some trend analysis of investments held and made in the sector.

The survey was conducted by obtaining a list of the top 1000 charities by income in the United Kingdom from the Top 3000 Charities 2012/13 publication produced by CaritasData. The sample selected comprised 100 charities from the list of the top 1000 charities by income. Of these 100 charities, 20 were randomly selected from the top 100 charities, 20 from charities ranked 101 to 200 and the remainder from the top 1000 charities. Older accounts have been used where the recent accounts have not been filed.

The split of the charities surveyed by year end was as follows:



In certain instances, we have provided results split by top 100 charities, charities ranked 101-200 and other charities in the top 1000 for the interest of the reader.

We have included in Appendix 3, a list of trustees' annual report disclosures required for investments (based on Accounting and Reporting by Charities: Statement of Recommended Practice (revised 2005)) and in Appendix 4 some considerations for trustees. This is not an exhaustive list of considerations in respect of investments but served as a starting point in helping us design some of the questions posed in this survey.

Section 4 – Survey results

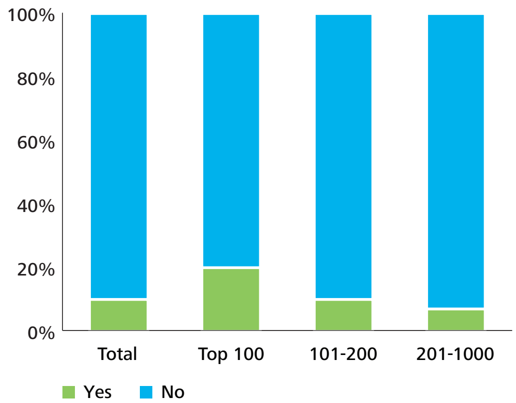
This section sets out our survey findings in respect of compliance by charities with regulations as outlined in Appendices 3 and 4.

4.1 Types of investments

We have discussed the main types of investment in Section 2. However, as we can see from figure 1a in our sample there were few charities holding anything other than financial investments. As the social investment revolution picks up speed it is important to remember that it is not just corporate, financial and government groups that can make social investment. Charities themselves can make social, programme related, investment to further their aims. As could be expected the largest charities are contributing most in this type of investment with 20% of charities within that group having some type of programme related investment.

Figure 1a. Does the charity have programme related investments?

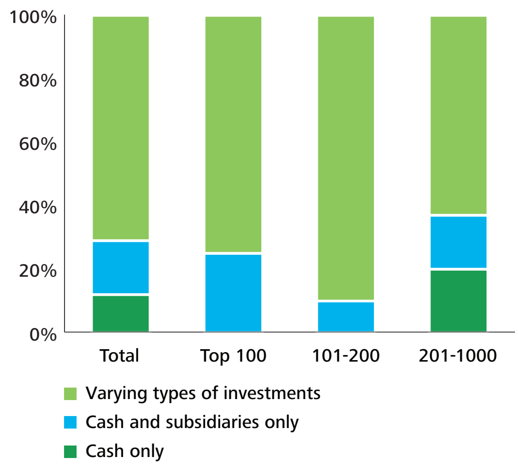
Number of charities



However, in our sample there were a number of charities whose investment holdings may be considered basic with almost 30% of the sample holding investments in cash balances and subsidiaries only.

Figure 1b. What type of investments are held?

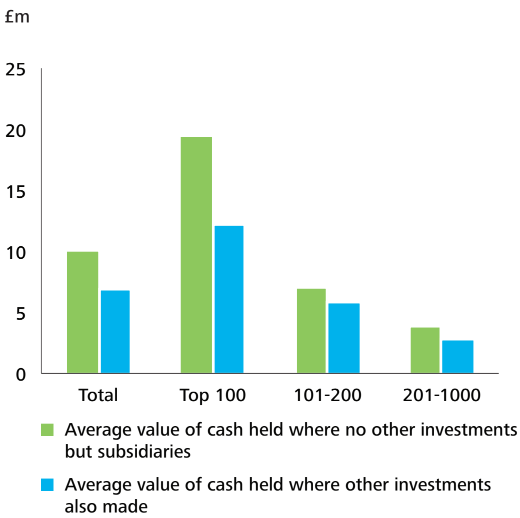
Number of charities



As perhaps expected the greatest number of charities with basic investment holdings, cash or cash and subsidiaries only, are in the smallest charities segment. However, although none of the top 100 charities sampled held cash alone, a quarter had only cash and subsidiaries. The middle sized charities sampled were the most active investors.

Across the charities sampled the cash balances held were relatively high with an average balance of £8.5m being held. In the top 100 charities cash balances were high even where other investments were held, suggesting a conscious decision to maintain high cash balances. This was reflected in a number of accounting policies that focused on the need for liquidity and short term deposits to manage charity activities and being ready for potentially short notice cash calls. As a percentage, cash accounted for an average of 8% of gross assets with smaller charities holding proportionately higher cash balances at 14% of gross assets.

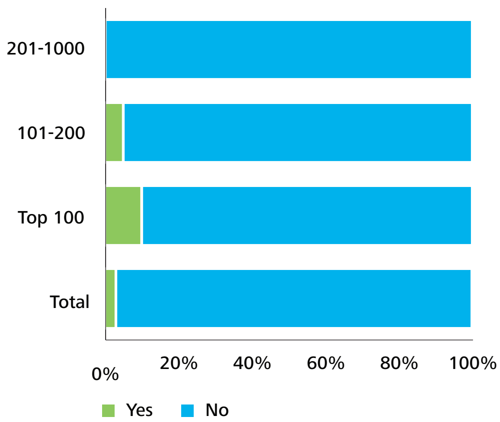
Figure 1c. What is the average value of cash held?



4.2 Investment in charities

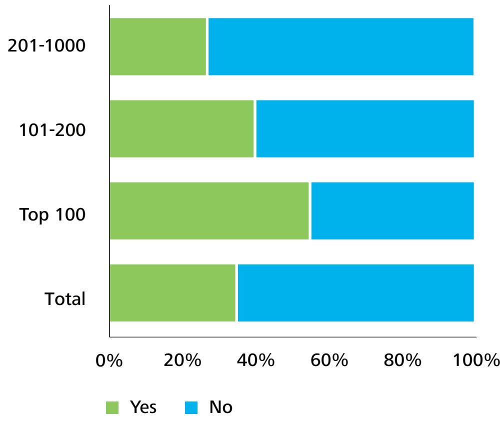
Investment in charities is discussed in Section 2 and in greater detail in Appendix 4. However this type of funding directly in charities remains in the minority, with only 3 charities within our sample having that type of investment in their accounts.

Figure 2. Does the charity receive outside investment?



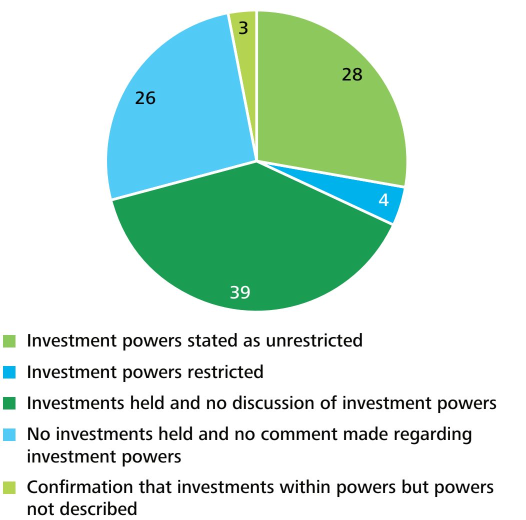
4.3 Investment powers

Figure 3a. Does the charity describe its investment powers?



Trustees' powers to invest are broad. Some restrictions are found within governing documents, but many restrictions are imposed by trustees within their ethical investment policies or based on their judgments over investment risk, focus on investment mix and liquidity requirements. The SORP does not specifically require charities to clarify their investment powers but they are required to give details of their investment policy and any other considerations that are taken into account. Of charities surveyed 35% did give information on their investment powers, many as part of their investment policy explanations, some as part of their governance arrangements. This information is useful to the reader as it allows the reader to distinguish between restrictions imposed by law and those imposed trustees reflecting the ethics and risk approach of the charity.

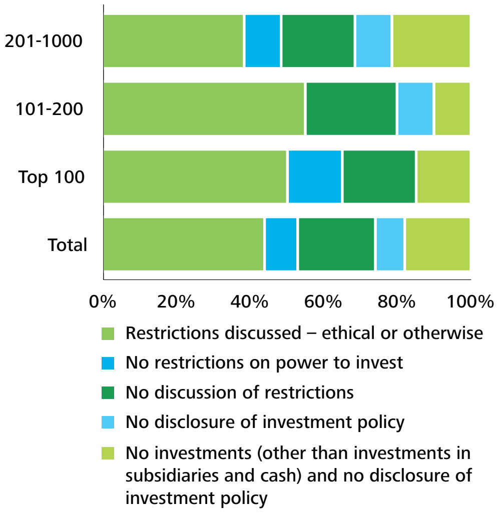
Figure 3b. What do charities disclose regarding investment powers in their reports? (%)



4.4 Investment policy

The SORP requires that where material investments are held, the investment policy and objectives, including any social, environmental or ethical considerations are disclosed. It should also be noted that significant cash balances are a form of investment.

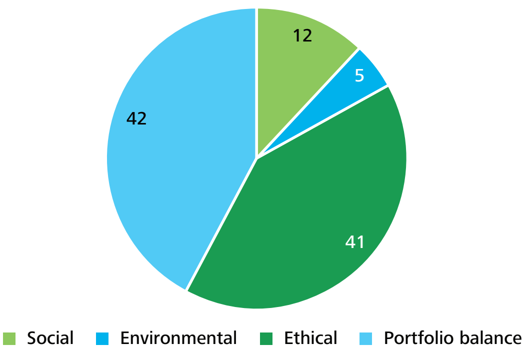
Figure 4a. What do charities disclose about their investment policy?



More charities disclosed information on investments and restrictions in their policy than made a specific statement on investment powers. However, of those charities surveyed, 8% did not comply with the requirement despite having financial investments other than cash and subsidiaries. Of those charities with investments in cash and subsidiaries only with no other types of investment, 34% included an investment policy statement which, in the main, explained the charity's need for cash and very liquid deposits.

Of the total number of charities surveyed, 21% had no discussion of any trustee-imposed restrictions and 9% explicitly stated that there were no trustee-imposed restrictions on the investment powers.

Figure 4b. What kind of restrictions do charities employ? (%)



Of those 44% of charities disclosing restrictions, 41% of the restrictions related to ethical policies. However, a significant number of restrictions were regarding the balance of the portfolio between the type of investment held with trustees setting guidelines within which investment managers were expected to operate.

4.5 Investment objectives

The SORP requires a charity to state both its investment objectives as part of its policy. Whilst 74% of charities disclosed a policy, only 64% of charities were clear about their objectives.

Figure 5a. Does the charity disclose their investment objectives?

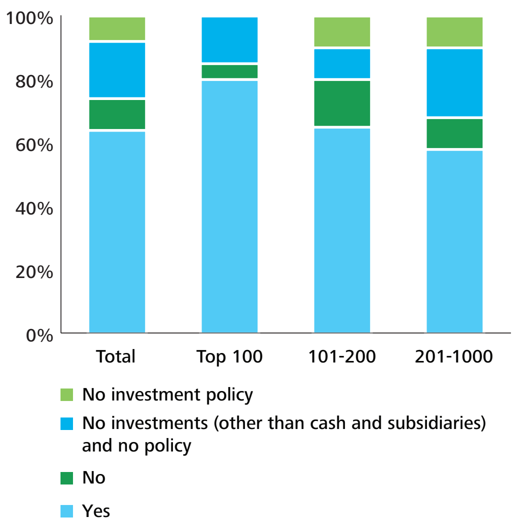
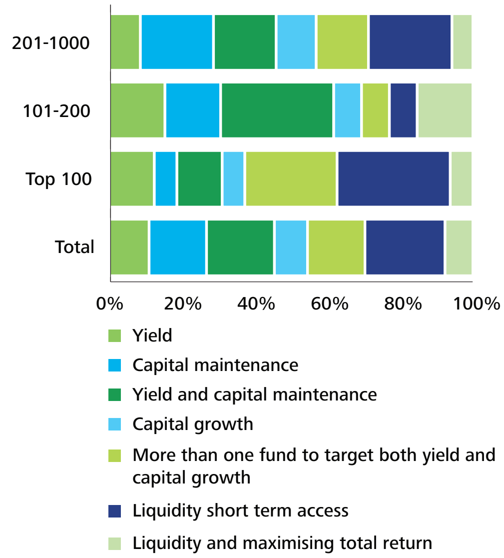


Figure 5b. What is the charity's investment objective?

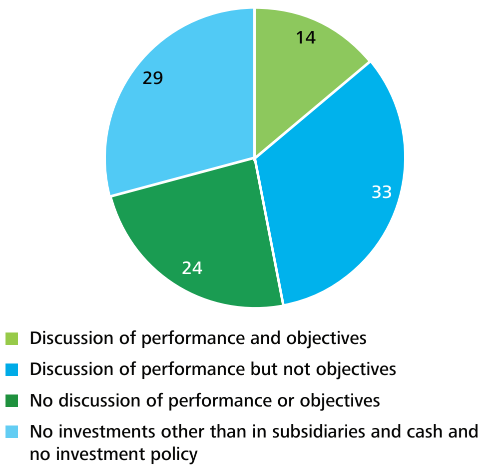


Of those charities including an objective, there was variety in both the objective and the clarity with which it was expressed. Whilst some of the headings above overlap they represent the common phrases used to describe objectives. The importance of liquidity is demonstrated in both the largest and the smallest charities and the focus on yield and capital maintenance was most significant for the middle sized charities.

4.6 Investment performance

The SORP requires that where material investments are held, the performance should be compared to the objectives set. 66% of those charities surveyed with financial investments other than subsidiaries and cash included discussion of investment performance.

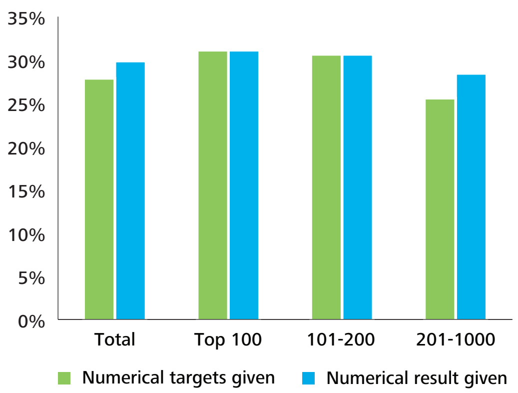
Figure 6a. Does the charity's annual report include discussion of investment performance?



Only 30% of those including a discussion of investment performance directly assessed their performance against targets either wholly by discussion or through including a numerical target or result.

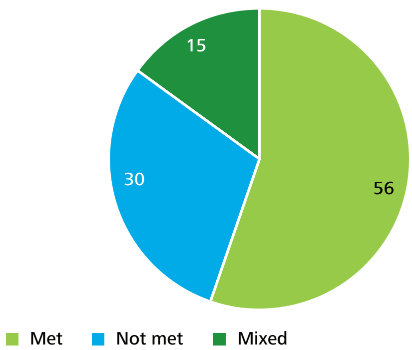
Of the charities surveyed which included such discussion, the charities in the 201-1000 bracket were more forthcoming with their specific targets and results. A reason for this may be the simpler, or singular nature of the funds and investments making a target easier to describe and summarise, however this is something that the largest charities should consider further, particularly given the size of their investment holdings.

Figure 6b. How many targets and results are reported numerically (% of those reporting objectives)?



Targets ranged from 14.5% to 0.3% return for the various types of funds. Given the markets over the period of the report results ranged from 14.6% (exceeding the 14.5% target) to falls of over 3%. Figure 6c shows that of those who reported a result (narrative or numerical) over half declared their targets to have been met.

Figure 6c. Did the charity meet their target (% of those reporting a result)?



4.7 Details of trustees, responsibilities for investments and investment managers

The SORP also requires charities to disclose details about the names of the trustees and other members of the senior management team to whom day to day management is delegated. Trust law allows trustees to delegate their responsibility for investments either through a committee or to an investment manager. Where such a delegation is made trustees retain responsibility for establishing a contract and/or terms of reference and monitoring performance against that contract or terms. Of the charities surveyed 59% retained the power over the management of investments with the full board, or board supported by an advisory committee (or did not describe arrangements in their accounts). 29% explicitly stated that they had a subcommittee to manage investments and 12% delegated directly to an investment manager.

Figure 7a. Who manages investments (%)?

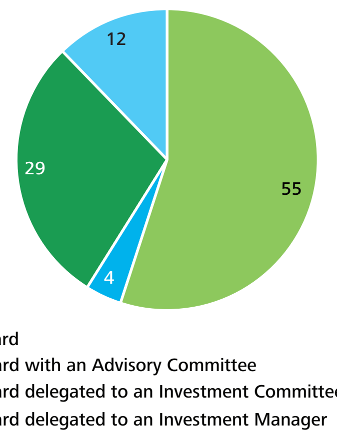
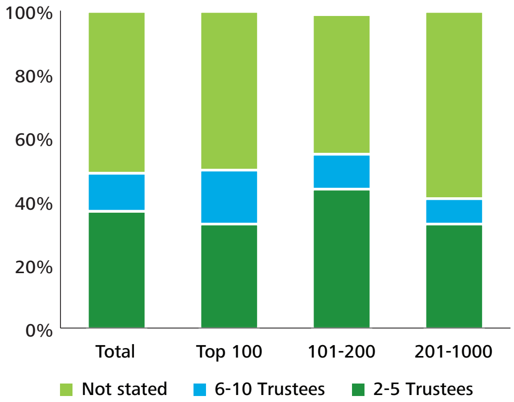
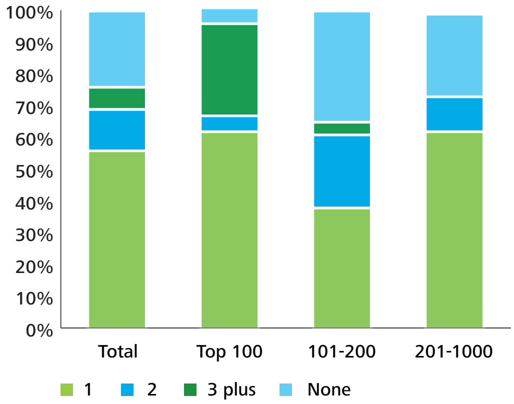


Figure 7b. How many trustees on the investment or advisory committee?



Of the charities who referred to an investment or advisory committee, 49% gave further details about membership of the committee. 75% of investment committees (where the number of members was stated or listed) had 2-5 trustees. No committees had just one trustee and a quarter had six to ten trustees. In many cases trustees with specialist knowledge were included or were trustees who also sat on the finance committee.

Figure 7c. How many investment managers?



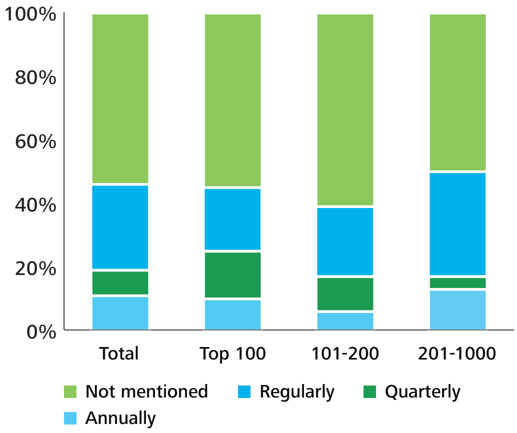
Many charities (76%) had at least one investment manager with 7% having over 3. Those with the higher number of investment managers tended to have segregated types of investment or portfolios with varying objectives.

4.8 Investment monitoring

It is important that trustees maintain control over their investments even where day to day management is formally delegated. This includes monitoring performance against targets and against any investment rules set out in their policy. Further, it includes a regular review and reassessment of the policy, the aims of holding investments, the objectives in light of their importance to the charity's mission and assessment of the investment managers themselves.

Only 49% of charities surveyed included information on how regularly they monitored or reviewed investment managers, and policies. The most commonly used phrase was 'regularly' which was not always defined, but could include anything monthly to half yearly review to longer. Similarly the distinction between reviews of performance and reviews of policy were not always made. This lack of clarity meant that it was not generally possible to distinguish between what was effectively a management review against annual targets, and how often trustees in a more strategic role reviewed both the policy and the persons responsible for carrying out that policy (for example by tendering investment management services).

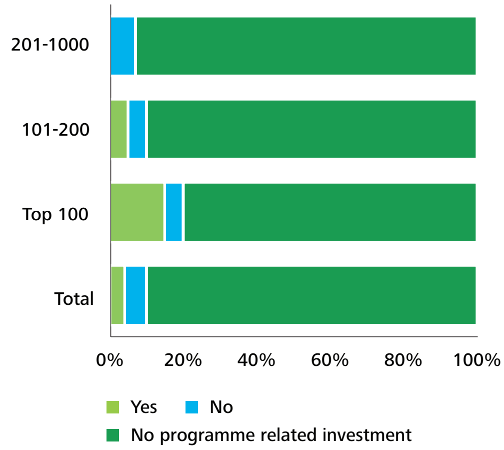
Figure 8. How regularly does the charity review its investment manager and policy?



4.9 Programme related investment

As discussed in 4.1 there were very few charities in our sample which had any programme related investment. Of those which did give loans or have some longer term arrangements included in their balance sheet, less than half (40%) included a policy for such investment in their trustees report in accordance with the SORP.

Figure 9. Did the charity include a Programme related investment policy?



Section 5 – Benchmarking investments

This section sets out our survey findings in respect of the investment information reported by charities in their Annual Reports.

These figures arise from our sample based on charity size by income and do not represent any other grouping that may be used for benchmarking the activities of an individual charity. However they do indicate the prominence of investments and the importance of investment decisions; particularly the conflict between obtaining the best return and seeking to maintain liquidity. The figures are obtained from reported accounts and the analyses below have been based on required SORP disclosures. Where disclosures have been incomplete or insufficient to allow full analysis of investments between SORP categories, the balance of unanalysed investments has been included in other. Investment management fees, are again only as disclosed in the accounts. Where charities did not disclose their fees they have been removed from the analyses provided relating to fees in figures 6a to 6c, accordingly these charts are based on a smaller sample than originally selected.

5.1 Cash and investments

On average cash and investments contributed to almost 40% of the value of the gross assets of all charities sampled. This demonstrates the significance of the decisions being made by trustees around cash and investments.

Figure 1a. What is the average composition of gross assets from our sample?

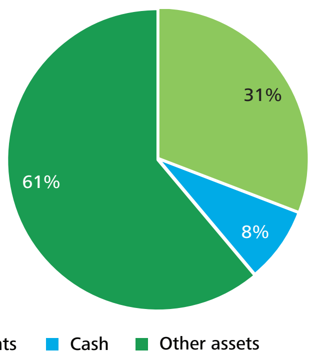
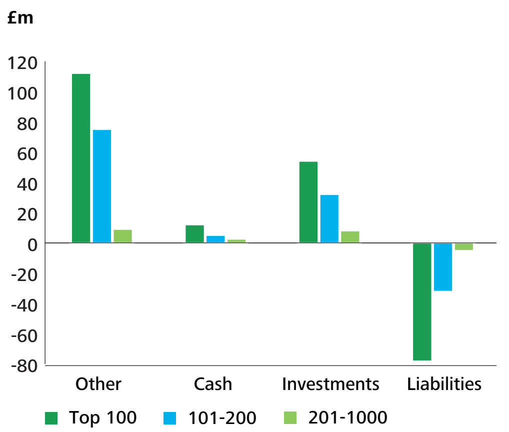


Figure 1b. What is the average composition of gross assets by size of charity sampled?

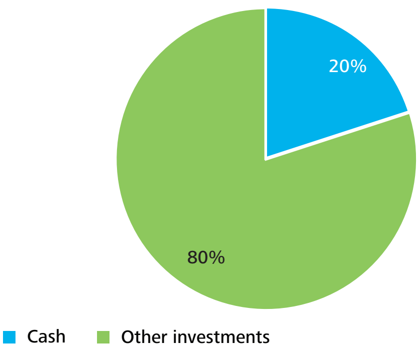


As can be seen the absolute average value of investments diminishes with the size of the charity as expected, but proportionately the importance of investments within the charity's assets increases. Thus while investments account for on average 30% of the top 200 charities' gross assets, they are 42% of those sampled in the 201-1000 category. Other significant assets held in the sample were tangible assets (including housing association property) and heritage assets.

5.2 Portfolio cash

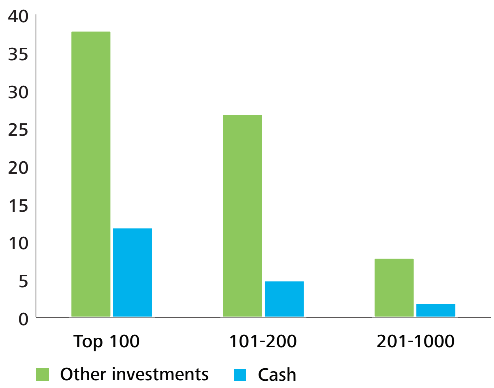
Even within reported investment balances there were substantial cash balances and the emphasis placed on liquidity has been noted in Section 4.

Figure 2a. What is the cash holding within an average portfolio?



Cash holdings within a portfolio are significant reflecting perhaps the uncertainty surrounding equity investments since the stock market falls of a few years ago. However, interest rates and investment returns for such balances remain comparatively low in line with the Bank of England base rate. The need for liquid assets is mentioned in a number of reports in terms of investment requirements and strategy (see also 4.5 and 5.4 below) and the results in Figure 2b below shows that the largest charities sampled are holding significant cash balances (24% of their investment portfolio compared to an average 18% for the other charities).

Figure 2b. How does the cash holding within an average portfolio vary by size of charity?



5.3 Portfolio mix

We have noted from the annual reporting survey that there is a trend to disclose more information regarding the portfolio mix, or intended mix in the trustees report.

The average mix from the charities surveyed was biased towards equities, UK and overseas, cash and fixed interest securities.

Figure 3a. What is the average mix within an investment portfolio (fixed and current)? (%)

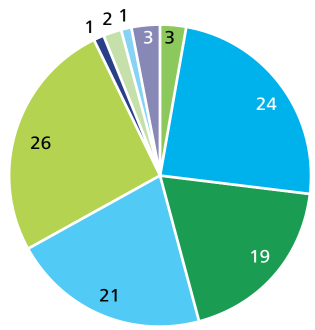
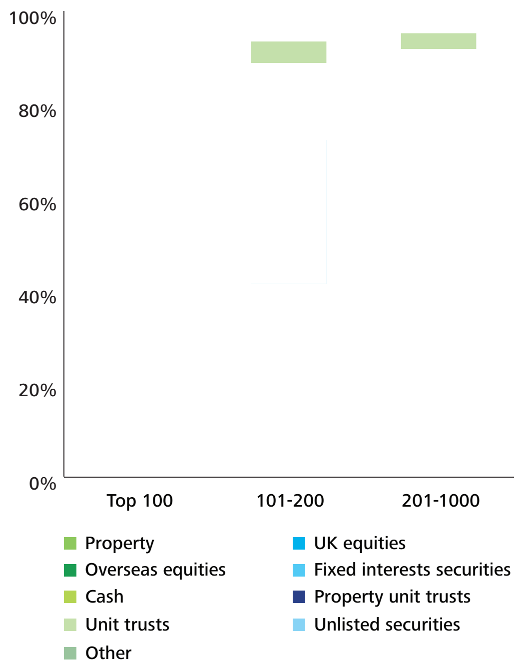


Figure 3b. How does the average mix of an investment portfolio (fixed and current) vary by charity size?

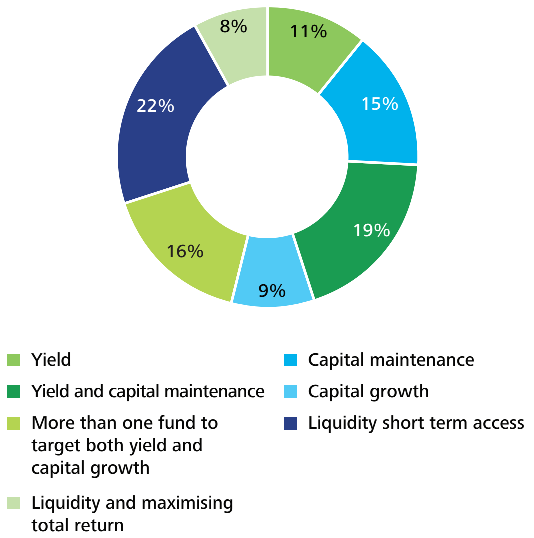


The significance of the cash balances is yet again clear, in particular the 34% of cash held within the largest charities' portfolios. Other includes a variety of investments from 'Alternative Investments' to gold, woodland and works of art.

5.4 Investment strategy

Figure 4 demonstrates the variety of investment strategies declared in the accounts. These investment strategies represented below have two opposing focuses of liquidity, short term, and capital maintenance and growth, looking to the longer term.

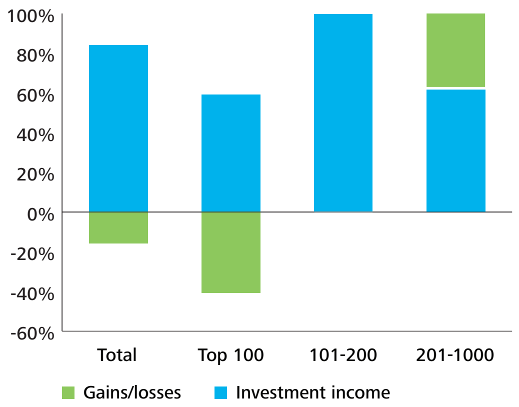
Figure 4. Which investment strategies have been chosen?



5.5 Investment return

The return on investment can be judged many ways and of course is dependent upon the investment strategy and the mix of investments. The return is made up of gains and income. Where charities hold investments for the long term unrealised losses reflect the market movements but may not be significant to charities as those losses only crystallise if the asset is sold. From the survey results in figure 5a the smaller charities appear to significantly buck the market trend. Part of this result however appears due to the particular investment mix of the charities in the 101-200 bracket of our sample and, in particular, the investment property holdings.

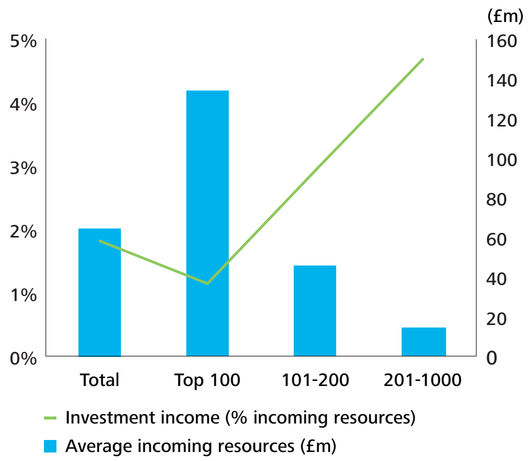
Figure 5a. What makes up the investment return – gains or income?



But how important is the investment return to charities. Investment balances are high and back endowment and restricted funds giving long term security. However, income generated from those assets is relatively low compared to the income generated from the other activities of the charity.

Figure 5b shows the return on investments is more significant to charities outside the top 100 as a proportion of their total income: investment income being over 4% of income rather than nearer 1% for the top 100 charities.

Figure 5b. What percentage of incoming resources relates to investment income?



Figures 5c and 5d show comparative the return on investment (as a percentage of the assets invested) compared with the portfolio mix and objective. The smaller charities from our sample are generating a higher return which appears influenced by the property elements of the mix and the capital maintenance and yield elements of the portfolio. The focus on capital growth in falling markets and a significant amount of liquid assets appears to have contributed to the lower returns generated by the top 100 charities.

Figure 5c. Average return compared to objective

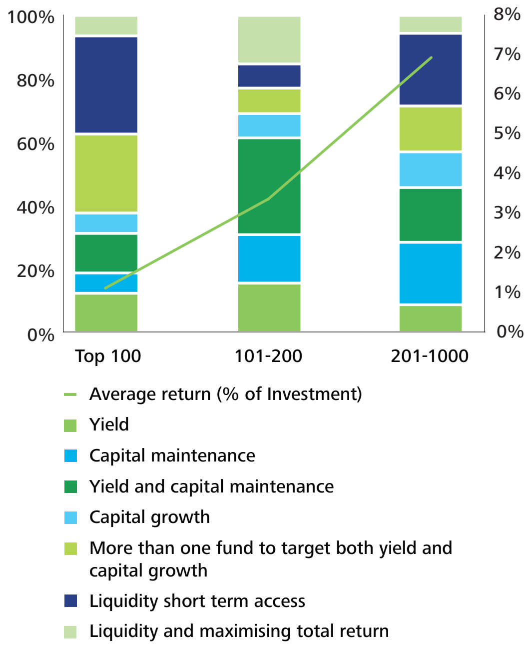
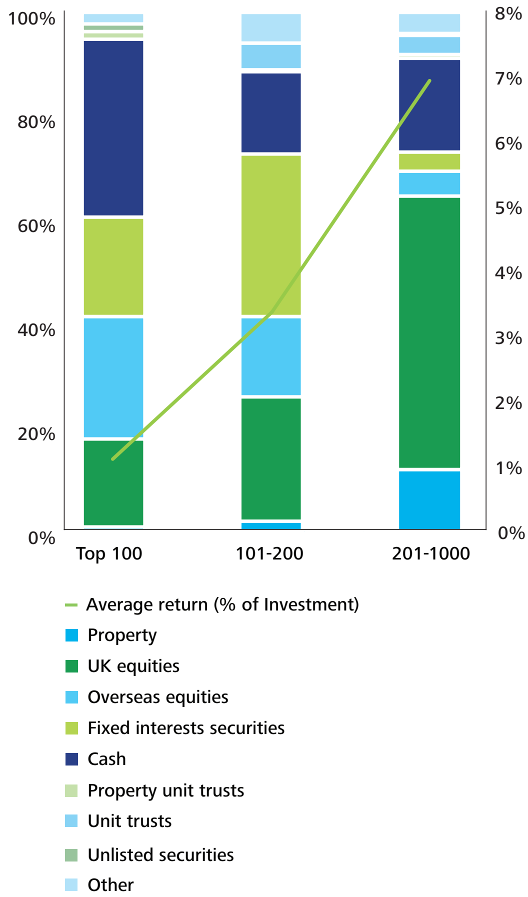


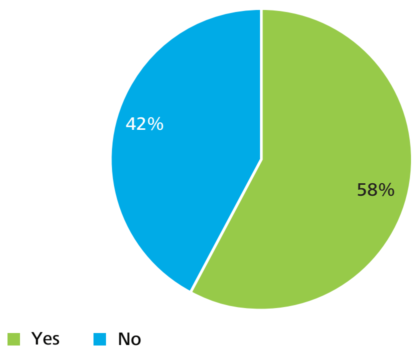
Figure 5d. Average return compared to portfolio mix



5.6 Investment managers' fees

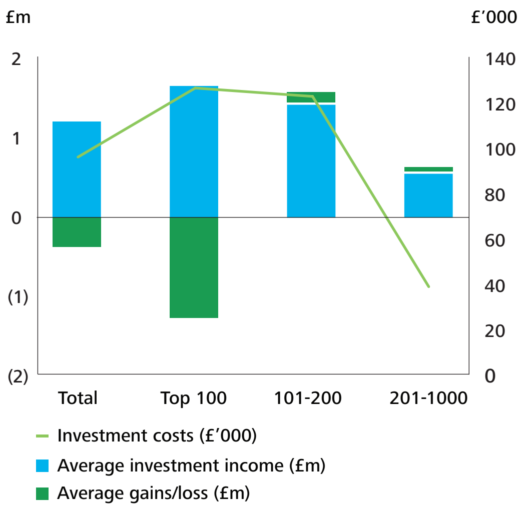
The SORP requires charities to disclose their investment management costs. 42% of charities within our sample did not make clear what their cost of investment was.

Figure 6a. Does the charity (with investments other than cash and subsidiaries) report their costs of investing?



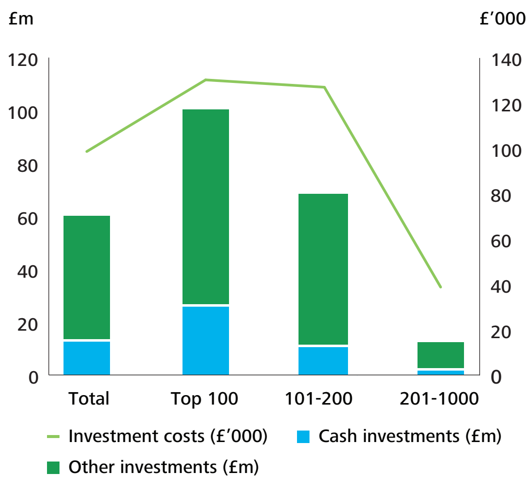
However, even with the fees disclosed there are potential issues of comparability as these may be a combination of the fees paid to the investment manager and any additional costs associated with the underlying funds themselves, depending on the level of detail available to the charity. The analyses below are only for those charities disclosing investment costs, a smaller sample than the analyses above. In the top 100 charities, the average gain was in fact a loss.

Figure 6b. How do investment returns compare with costs?



Investment management costs are on average just below £40,000 for the charities in the 201-1000 bracket; however the top 200 charities' costs are on par with average fees disclosed being just below £130,000. Those fees were on average approximately 8% of the investment income received.

Figure 6c. How do investment costs compare with total investments?



On average fees were 0.25% of investment balances (excluding cash balances as many of these were held outside portfolios), with smaller charities paying slightly more at around 0.4% and the larger charities correspondingly less.

Appendix 1 – Financial investments

Many charities hold significant reserves in the form of cash accounts or investment portfolios to support future projects, or are holding assets yet to be assigned to a project. Such portfolios have often been put in place many years ago and, oversight in terms of the level of risk or the target return has not always been necessarily maintained. There is a considerable difference in the return potential, and therefore risk impact, of different investment strategies. This has the potential to impair or enhance a charity's ability to fund future projects, fundraise and increase profile. Interest on cash held on deposit has never been lower and with such uncertainty in global markets it is right that charities consider:

- Is a cash return sufficient with inflation running at over 3% against a cash yield of around 0.5%?

- Where an investment portfolio is utilised, how much risk is being taken and what is the impact on the charity if there is a marked drop in asset value of the reserves?

- How does the investment time horizon compare with the need to divest to support projects?

Keeping pace with inflation necessitates risk!

Following the global credit crunch, cash rates collapsed from 5% in April 2008 to 0.5% in March 2009, where they have remained. Inflation on the other hand, since 2009, has averaged over 3%. Therefore, in real terms, cash investors may have been losing purchasing power at a rate of around 2.5% per annum. This is of particular relevance to charities whose future expenditure is more likely to be linked to inflation than base rates. Additionally, cash investors have needed to consider the security of the balance sheets on which their assets are placed. While the worst seems to be over in terms of banks defaulting, these incidents can result in depositors losing money.

Although cash portfolios are currently resulting in a loss of assets in real terms, taking investment risk to try and outperform inflation and achieve a more meaningful return can result in capital losses. Such capital losses may have an impact on a charity's ability to support its work. This can also be true where income from investment portfolios is used by the charity for the day to day running of the charity. Where investment risk is being taken, charities need to consider how to assess downside risk. There is always a range of potential outcomes from an asset portfolio and some outcomes will have consequences.

What is the intended purpose of an investment portfolio?

Answering this question is not straightforward and often it is informative to initially consider what the objectives are for any particular pot of assets, in particular:

- How important is capital preservation?

- What is a reasonable return objective to target in the current environment?

- How much risk is it reasonable to take to achieve that?

- What are the income requirements?

- What are the consequences of not achieving the objectives?

- What are the time horizons?

Many investment portfolios will be earmarked for future use and capital losses can result in failure to undertake important projects or budgets being rewritten. Where portfolios are earmarked for future use charities should carefully consider the timeframe for completion, the required capital value, and the impact of postponement and therefore the required investment return and level of risk that can be borne to achieve said return. Equally where portfolios are being run for "rainy day" scenarios, charities should consider what scenarios would result in the need to dip into these assets and importantly how the portfolio of assets will have performed going into this scenario. For example, if a portfolio invests wholly in equity investments, and in a scenario where global markets continue to fall in value with cash pressure on consumers, it is likely that charitable donations could significantly reduce at the same time as investment portfolios are falling in value; an unhelpful combination.

An alternative type of investment fund is one used to generate an income stream where the income is then used to fund charitable work or ongoing projects. In these circumstances capital preservation may be less of a concern as the charity may be able to withstand capital movements so long as the income being generated is not impaired. For example if an investment fund holds a bond paying 6% per annum, the charity may not be too concerned if the market places a lower value on that bond since it is not intending to sell the bond – so long as it is confident of getting the 6% coupon every year and the capital back at the end of the term.

Additionally charities should consider the liquidity needs for investment portfolios. The more liquidity required (e.g. for short term capital projects) the more the investment portfolio should be weighted towards assets less likely to "shock" in value over the short term.

Uncertain market environment

We are in a unique market environment characterised by uncertainty. The global debt crisis continues with the burden shifting to central governments which have responded by pumping liquidity into their local markets. Although equity markets have been strong over the last 12 months and arguably remain reasonable value based on fundamental factors, global markets remain unbalanced and the extent to which central governments can support their banking sectors will continue to be tested in local markets. Global economies are yet to fully deal with the debt crisis as we move into an age of austerity where low growth could be the new norm and global markets become inextricably interlinked. Equally, the impact of the extraordinary amounts of quantitative easing that continues to take place in the UK, US and Europe remains the world's largest inflationary experiment with exit strategies and knock on impacts largely unknown.

In this environment cash may appear a safe home for capital stability but generates little income for investors and investing just to keep pace with inflation requires investors to take a not insignificant level of investment risk. In contrast to cash, since the turn of the year, global equities have performed strongly whilst income yields available on fixed income securities remain at very low levels. In these difficult markets where volatility can result in unexpected underperformance and secure assets risk capital depreciation, holders of investment portfolios would be wise to both reassess their risk profiles within portfolios and challenge their investment managers on how they balance the need for meaningful return against the risk of capital losses.

We believe, in such difficult markets, it is hugely important for holders of investment portfolios to review the risk frameworks for their investment portfolios to ensure:

- Appropriate governance structures are in place to review and challenge investment managers.
- Risk and reward trade-offs are properly understood and appropriate restrictions are in place to avoid investment portfolios taking too much (or too little) risk for the required return.
- Income requirements are clear and portfolios are geared to deliver income without having to eat into capital.
- Appropriate fees are being charged. In a low yield environment where cash is yielding 0.5%, and both treasuries and corporate bonds yielding less than 5%, fees can have a more meaningful impact on the overall return.

Governance is key

Charities with significant investment portfolios should also consider the governance structure around the management of portfolios. Often investment portfolios are left in place to run without appropriate challenge and without independent assessment on whether it has been successfully managed and represents value for money. Furthermore, mandates for investment portfolios can be fairly bespoke with grey areas between delegated responsibilities. There are broadly two types of delegation involved in running an investment mandate. Firstly, where the client sets the asset strategy and delegates the implementation of the strategy to an investment manager; and secondly where no specific investment strategy is set but risk is defined through a process of profiling. Charities should be aware of the level of delegation within mandates and challenge whether their role is active enough in reviewing the elements of delegation within a mandate. This will include for example, reviewing the provider, the benchmark strategy against which the mandate is run, and the purpose/objectives of the strategy.

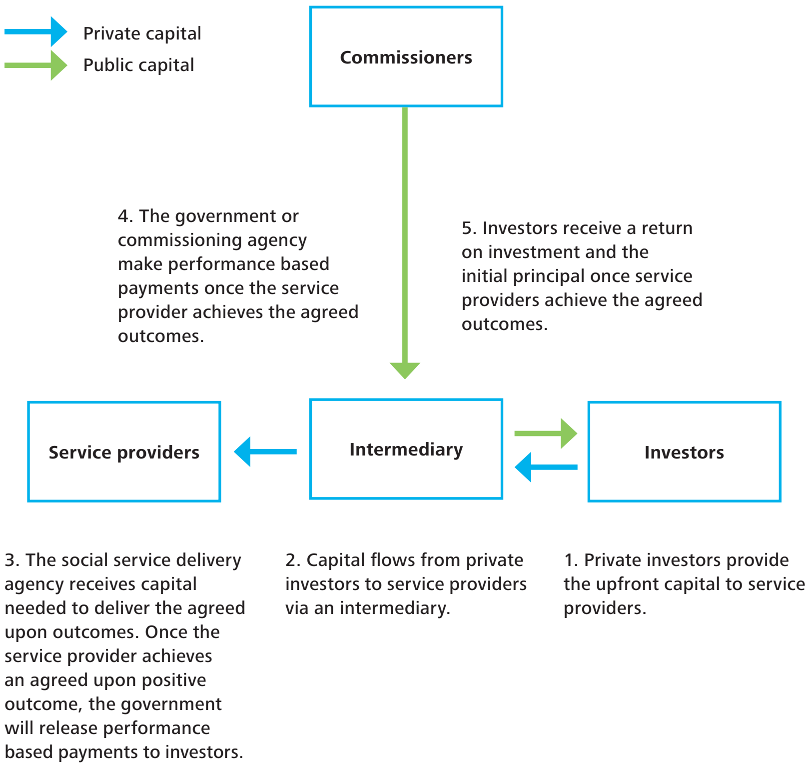
Overall, the impact of asset returns in these portfolios can be significant for the running of a charity and assessment of the performance and risk within such mandates is key in such volatile market conditions. Additionally the governance structure around these mandates needs to be robust with investors fully aware of the decisions they themselves are taking and the potential impact of those decisions.

Appendix 2 – Social investment bonds and other funding

At Deloitte, we are highly passionate about creating and implementing a sustainable and fair society. In pursuit of this strong philosophy and belief, Deloitte as a responsible business leader has in the past year successfully led and delivered on Social Impact Bonds. These bonds create widespread opportunities and benefits to society.

Six Impact criteria for a SIB
The following conditions are necessary for success in leveraging Social Impact Bonds.

- **I** — **Indicators:** clearly defined parameters that are simple and reflect the desired impacts.
- **M** — **Measurement:** metrics are required to be quantifiable in order to evaluate success.
- **P** — **Positive outcomes:** the impact must be beneficial to society.
- **A** — **Attribution:** the outcomes need to be attributable to the service provider.
- **C** — **Cashability:** the outcomes created by the service provider must result in definable cash savings to the commissioner.
- **T** — **Transparency:** clear visibility of results and savings throughout the process is critical.



A Social Impact Bond (SIB) is principally a three-way relationship between the government/local authority, an investor and a charity/social enterprise. The overall outcome and goal of this structure is a commitment to provide significant improvement(s) to the welfare of society.

During present times of financial constraints and reduced public spending, the SIB has emerged as an innovative financial mechanism for an investor to fund service providers (charities/social enterprises). If the agreed upon outcome is positive to society with the added advantage of financial savings then the commissioners (government/local authority) will be in a position to provide a financial return back to the investor. An intermediary will also be brought on to act as an independent advisor to the commissioners, investors and service providers with overall responsibility for project management.

Opportunities created by Social Impact Bonds

The aim of the SIB is to undeniably allow the parties concerned to work together with an innovative approach to tackling societal challenges in society. The focus and outcome is 'doing good in society' and the success of the SIB will wholly depend on this. SIBs are therefore able to actively align and strengthen the relationships of those parties engaged in the process thus providing an avenue of early support and funding to service providers by investors during critical times of curbed public spending.

They are therefore an attractive and alternative mechanism to unlocking available funding with the dual effect of creating a level of confidence to the service provider of a consistent stream of funding. For investors it is an opportunity to align financial objectives alongside societal good. However, measurement and performance is at the heart of the process where the success and failure of a SIB will affect all parties engaged in the process.

How can Deloitte help?

If you wish to consider SIBs, bear in mind that you will need advice from strategy design, readiness checks, to implementation support and you will also need professional advisers to act as an independent intermediary.

- Impact measurement
  Consider how you can build appropriate and robust impact measurement techniques for your charity. You need to be able to measure the economic, environmental and social impacts created by your organisation.

- Impact reporting and metrics
  We need to develop in-depth experience in the design of relevant economic, environmental and social impact metrics.

- Impact investor networking
  You need to find investors to introduce them to exciting investment opportunities; assist service providers explore the impact investing landscape and links to potential commissioners.

- Impact assurance
  You need to have a critical overview of performance and help provide confidence to commissioners and investors alike on reporting.

If you require further information on SIBs or wish to discuss any issues relating to them, please contact our SIB team.

Appendix 3 – Trustees' investments disclosure checklist

The list below summarises the main narrative and disclosure requirements as at 31 March 2013 relating to investments[8] and is based on the Charities SORP which was published in 2005 together with, where applicable, the Companies Act 2006 and the relevant accounts and reports regulations. The tax implications of investment, what constitutes charitable investment and what may be considered trading have not been considered here and any questions in relation to these matters can be directed to your tax team or the tax contacts highlighted in Appendix 5.

Charities SORP requirements (Although charities that fall outside of the audit threshold are exempt from certain disclosures it is considered best practice to include them)	**Ref.**	**Yes**	**No**	**N/A**
Objectives and activities Where social or programme related investment activities are material in the context of charitable activities undertaken, the trustees' report should explain the policies adopted in making such investments.	SORP 2005 Para 50			
Charities that are not subject to a statutory audit requirement need not provide this disclosure.	SORP 2005 Para 52			
Achievements and Performance The trustees' report should contain information that enables the reader to understand and assess the achievements of the charity and its subsidiary undertakings in the year. It should provide a review of its performance against objectives that have been set. The report should provide both qualitative and quantitative information that helps explain achievement and performance. Where material investments are held, the report should contain details of the investment performance achieved against the investment objectives set.	SORP 2005 Para 53			
Charities that are not subject to a statutory audit requirement may limit their disclosures within this section to providing a summary of the main achievements of the charity during the year.	SORP 2005 Para 54			
Financial review The trustees' report should contain a review of the financial position of the charity and its subsidiaries and a statement of the principal financial management policies adopted in the year. Where material investments are held, the investment policy and objectives, including the extent to which social, environmental or ethical considerations are taken into account.	SORP 2005 Para 55 (d)			
Charities that are not subject to a statutory audit requirement need not provide the disclosure set out in paragraph 55(d) above.	SORP 2005 Para 56			
Financial statements disclosure requirements The investment asset note to the accounts should disclose separately: a. investments held primarily to provide an investment return for the charity; and b. programme related investments (Glossary GL 47) that the charity makes primarily as part of its charitable activities.	SORP 2005 Para 299			
Where values are determined other than by reference to readily available market prices (Glossary GL 41), the notes to the accounts should disclose who has made the valuation, giving: a. the name and qualification (if any) of the valuer and whether they are a member of staff or a trustee or external to the charity; and b. the basis or bases of valuation.	SORP 2005 Para 300			
In the rare case where the size or nature of a holding of securities is such that the market is thought by the trustees not to be capable of absorbing the sale of the shareholding without a material effect on the quoted price, the trustees should summarise the position in the notes to the accounts. If they are able to do so, the trustees should give an opinion in the notes to the accounts on how much the market price should be adjusted to take this fact into consideration.	SORP 2005 Para 301			

8 For a disclosure checklist summarising the complete Charities SORP requirements as at 31 March 2013 please refer to Appendix 1 of our survey *Time for change… Surveying trustees' annual reports in the charity sector* published in August 2013

Charities SORP requirements (Although charities that fall outside of the audit threshold are exempt from certain disclosures it is considered best practice to include them)	**Ref.**	**Yes**	**No**	**N/A**
The notes to the accounts should show all changes in values of investment assets and reconcile the opening and closing book values. This information may be provided in a table format as set out in Table 9 of SORP 2005.	SORP 2005 Para 302			

Table 9. Analysis of Movement of Investments	**£**
Carrying value (market value) at beginning of year	
Add: Additions to investments at cost	
Less: Disposals at carrying value	
Add/deduct Net gain/(loss) on revaluation	
Carrying value (market value) at end of year	

The notes should also show the total value of investment assets at the end of the financial year divided between distinct classes of investment. This would normally include: a. investment properties; b. investments listed on a recognised stock exchange or ones valued by reference to such investments, such as common investment funds, open ended investment companies, and unit trusts; c. investments in subsidiary or associated undertakings or in companies which are connected persons (Glossary GL 50); d. other unlisted securities; e. cash and settlements pending, held as part of the investment portfolio; f. any other investments.	SORP 2005 Para 303			
Items in categories (a) to (f) of paragraph 303 above should be further analysed between: i. investment assets in the UK (see paragraph 305 below); ii. investment assets outside the UK.	SORP 2005 Para 304			
The total value of shares or investment schemes (including common investment funds, open ended investment companies and unit trusts) relating to companies listed on a UK stock exchange or incorporated in the UK are treated as investment assets in the UK and no further analysis is required of whether such entities invest their funds in the UK or outside the UK.	SORP 2005 Para 305			
Further details should be given in the notes to the accounts of any particular investment that is considered material in the context of the investment portfolio.	SORP 2005 Para 306			
The notes to the accounts should indicate the value of investments held in each category of fund. This may be included in the overall analysis of assets held in the different category of funds.	SORP 2005 Para 307			
Where the use of programme related investments forms a material part of the work of the charity, or the amounts form a material part of the investment assets of the charity, the notes to the accounts should show all changes in carrying values of programme related investments, including any impairment losses, and reconcile the opening and closing carrying values of such investments.	SORP 2005 Para 311			
The notes should also analyse programme related investments held between equity, loan and other investments and indicate the charitable objectives, programmes or projects the investment supports.	SORP 2005 Para 312			
Investment management costs are defined in the Glossary (GL38). Where investment management fees are deducted from investment income by investment managers, the charity should show as investment income the gross investment income before fees and report the fees within this cost category. [SOFA heading B1c: investment management costs]	SORP 2005 Para 187			
Companies Act 2006 Directors' report requirements				
There are no specific references to investments however information on significant investment movements would be captured by the business review requirements and where applicable directors must report on the use of financial instruments.	s417 Acc Regs Sch 7:6(1)(2)			

Appendix 4 – Trustees' investment powers

The list below highlights some of the considerations arising from the Charity Commission guidance CC14 which draws together into one document the legal underpinning relating to charities and investment matters. This was published in October 2011. The list should not be considered exhaustive and appropriate advice, legal or otherwise, should always be taken where there is concern over an investment issue. The tax implications of investment, what constitutes charitable investment and what may be considered trading have not been considered here and any questions in relation to these matters can be directed to your tax team or the tax contacts highlighted in Appendix 5.

Investment powers – some considerations for trustees	Ref	Notes
Do you understand your investment powers? The Trustee Act 2000 confers a general power of investment on trustees. This is stated to be that *'a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust'*. Trustees have to exercise their powers in the interests of the charity. This power applies only to financial investments. Note: The general power of the Trustee Act 2000 does not permit trustees to make an investment in land other than loans secured on land. However section 8 of the Trustee Act gives trustees the power to acquire freehold or leasehold land in the United Kingdom as an investment.	Trustee Act 2000	
Does your constitution or governing document restrict those investment powers? Under section 24 of the Charities Act 1993 the powers of investment of a charity include power to participate in common investment funds and common deposit funds unless the power is excluded by a provision in its governing document specifically referring to common investment funds or common deposit funds. Charities may choose to invest in a narrower range of investments either because their objects justified the restrictions or because the charity trustees considered investment was appropriate on financial considerations. Such ethical restrictions may be imposed by the governing document or by the Trustees themselves. Investment powers may be limited by the governing document or by the constitution. Endowments or other bequests may come with investment conditions that trustees would need to be aware of.	Charities Act 2011 para 96 et seq	
How do you exercise those powers? The Trustee Act 2000 imposes specific duties on trustees with regard to the exercise of their investment powers. In particular trustees must review the charity's investments from time to time and, having regard to the standard investment criteria, vary them if appropriate. These standard investment criteria are: (a) The suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind; and (b) The need for the diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust. Typically it is not permitted for trustees to borrow in order to invest. There are a number of decisions that trustees need to make with regard to investments and that are typically set out in the investment policy. Policy considerations should take into account at a minimum the following questions • **How often do you review your investment policy (strategy and objectives)?** • **What is your appetite to risk? Does your policy reflect that?** • **What targets suit your objectives (does that charity want income or gains)?** • **Which benchmarks are most applicable?** • **What are your criteria for the selection of investment options and minimum performance requirements that each option must reach?** • **How and how frequently do you assess/monitor the return on different types of investment assets?** • **How do you assess, determine, change the portfolio mix?** • **How often do you review/monitor return against targets?** • **What interventions would and could you take if necessary?**	Trustee Act 2000 Section 4	
Are you imposing any further restrictions? Where the trustees impose an ethical investment policy this should still be consistent with the principle of seeking the best returns. Case law has identified three situations where trustees can allow their investment strategy to be governed by considerations other than the level of investment return. 1) Where the particular type of business would conflict with the aims of the charity – **practical** conflict with the charity's aims and activities and not just moral disapproval. 2) A charity can avoid investments which might hamper its work through alienating supporters or making potential beneficiaries unwilling to become involved, however it must balance this risk against the risk of financial underperformance. 3) Trustees can accommodate the views of those who consider investments inappropriate on moral grounds if they are satisfied that this would not involve 'a risk of significant financial detriment'. Trustees need to make clear in their policy what their restrictions are and why they feel those restrictions are necessary and can be justified. Approaches to ethical investments may involve either negative screening (excluding certain types of industry/companies from their portfolio) or positive screening (only including companies that promote similar ideas or activities as fit with the charity's aims). Trustees must also determine how strictly any restriction should be adhered to, for example do they apply to direct investments only, or do trustees require that any funds they invest in will reflect the same ethical or economic policies.		

Investment powers – some considerations for trustees	Ref	Notes
Do the trustees have access to appropriate advice? A trustee must obtain proper advice, where he considers it necessary, from a person who is reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial and other matters relating to the proposed investment. The level of advice and experience immediately available to a charity will vary depending on the composition of the Board and management. Therefore each charity will need to audit the skills available to them and consider how to bridge any gaps.	Trustee Act 2000 Section 5	
Are any of the trustees powers delegated? Trustees have powers to delegate management of their investments which are in addition to any powers stated in a charity's governing document. A person authorised by a charity's trustees to exercise the general power of investment is subject to the duty to have regard to the standard investment criteria when exercising any power of investment. Trustees must ensure that any delegation of powers is clearly documented through terms of reference or contract and processes are established for review, and arbitration should that become necessary.	Trustee Act 2000 Section 11 Trustee Act 2000 Section 13(1)	
Have the trustees considered programme related investment as a way of furthering the charities objectives? Programme related investment (PRI) is justified as furtherance of the charitable purpose not as an exercise of the investment power. These are not considered to be financial investments and therefore not subject to the same legal restraints. Trustees must be prepared to justify their use of resources to meet and continue to be able to meet their charitable objectives. This may include making decisions between financial investments, programme related investments and immediate charitable expenditure. To successfully make PRI, be it through loans, investment in shares, guarantees or indemnities, the charity: • Must be able to show that PRI is wholly in furtherance of the charity's aims; • Should make sure that any benefit to private individuals is necessary, reasonable and in the interests of the charity; and • Should consider reasonable and practical ways to exit from a PRI if it is no longer furthering the charity's aims. The advantage of loans, for example, is that repaid capital can be recirculated and the funds used many times, the risks include needing to undertake due diligence in loan assessment and active portfolio management. Indemnities and guarantees can support smaller charities and organisations in obtaining their own finance and does not diminish a giving charity's reserves, however the guaranteeing charity must ensure that, if called upon, it can both stand the payment and remain within its charitable objectives by doing so.		
Has any investment in subsidiaries been evaluated? Many charities have trading companies which may be held for either income generation or for conducting activities which further the purposes of the charity. In late 2012, the Companies Act 2006 was amended to provide a new exemption from audit for subsidiaries[9] with an EEA parent that is willing to guarantee the subsidiaries' debts and liabilities. Dormant subsidiaries with such a guarantee are additionally exempt from preparing and filing financial statements. Following that announcement the Charity Commission issued guidance to clarify that a charity cannot give such a guarantee to a non-charitable subsidiary because it risks charitable funds being used for a non-charitable purpose were the guarantee to be called upon. The Charity Commission has also stated that although a parent charity can give such a guarantee to a charitable subsidiary, the charitable subsidiary would still require an audit or independent examination under the Charities Act 2011 where it exceeds the relevant thresholds. Trustees must be prepared to justify any provision of funds to its trading company by either the financial return or the activities it undertakes.		
Has the tax impact of investments been considered? Where a charity, or charitable company makes investments or loans that are not approved charitable investments or loans as defined in law[10], it may be treated as incurring non-charitable expenditure. The tax impacts of the various types of investment are outside the scope of this survey. Please contact your audit partner, or a member of our tax team would be happy to discuss a particular situation.		

9 These changes take effect for accounting periods ending on or after 1 October 2012.

10 Under section 543(1) of the Income Tax Act 2007 a charitable trust is treated as incurring non-charitable expenditure if it makes any investments or loans that are not approved charitable investments or loans as defined in sections 558 and 561 Income Tax Act 2007 respectively. Under section 496(1) of the Corporation Tax Act 2010 a charitable company is treated as incurring non-charitable expenditure if it makes any investments or loans that are not approved charitable investments or loans as defined in sections 511 and 514 of the Corporation Tax Act 2010 respectively.

Appendix 5 – Deloitte's Charities and Not For Profit Group

Our dedicated Charities and Not For Profit Group is made up of specialists with expertise and a passion for working with clients in the sector. Please visit www.deloitte.co.uk/charitiesandnotforprofit for more information about the Group.

With access to a group of specialists spread across the country, we will provide truly local expertise and service, backed up by the resources of a National Team.

Please feel free to contact any of the team members if you would like more detailed information and advice or would like to meet with us to discuss any current issues for your charity.

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