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Pulse

Deloitte's Charities and Not for Profit Group Newsletter

As ever, there have been new developments in the sector over the last few months.

The ICAEW published its audit insights on charities. The publication looks at the impact that charities have and how they should deliver their goals and objectives in challenging times.

The Charity Governance Code for large charities was also published. This, in effect, replaces the "Hall Marks" of running an effective charity and whilst meant for larger charities, it should be adopted by all charities.

Information about the above and the developments can, as ever, be found on our website.

Thanks for reading!

Please note that the views expressed in this publication are those of the authors and not of Deloitte. In the complicated environment in which we all operate, always seek professional advice specifically and don't rely on contents of articles that have been written for general guidance only.

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Fraud Risk: Are you exposed?

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***Fraud:** wrongful or criminal **deception** involving, amongst other things, **false representation, failure to disclose information or abuse of position**, in order to make a gain or cause loss to another.*

Fraud is now the most common criminal offence in England and Wales. However, many organisations have not considered the risk posed by fraud nor taken appropriate steps to prevent, detect and deter it from happening.

The last public fraud survey estimated that fraud cost charities around £1.9bn annually[1]; money that was diverted away from charitable causes. However, whilst the impact of fraud on a charity can be significant financially, the potential reputational damage can often be far greater than the financial cost.

What action have you taken?

- Have you undertaken a comprehensive fraud risk assessment within the last 12 months to identify the key fraud risks you face?
- Have you been a victim of fraud, and if so, have steps been taken to prevent this from reoccurring?
- Is there a structured programme to prevent, detect and deter fraud across the organisation, incorporating awareness campaigns targeted at high risk groups?
- Do you have a clear anti-fraud strategy which is proportionate to the fraud risks faced?

A typical organisation loses 5% of revenues in a given year as a result of fraud.

Source: Report to the Nation's 2016: Association of Certified Fraud Examiners

Vulnerability of charities

Charities are particularly vulnerable to the risk posed by fraud due to the reliance on altruism and integrity, both internally, from volunteers and staff, and externally, from the general public and suppliers. An emphasis on goodwill and trust can enable those who seek to commit fraud to operate with less suspicion than might otherwise be the case.

In addition, charities can be particularly susceptible to fraud as a result of the following common characteristics:

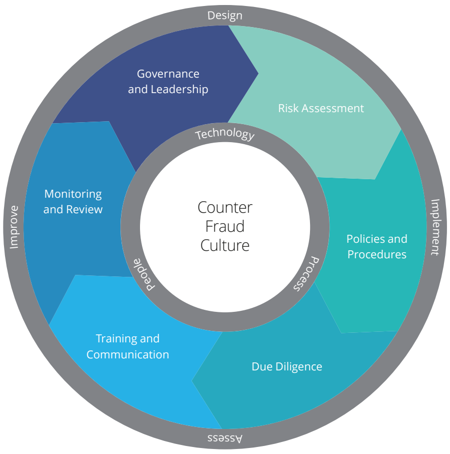
- High levels of cash and cash transactions.
- Less mature systems of control and assurance to prevent and detect fraud.
- Lack of investment in process automation, with greater reliance on people intensive processes that can be open to compromise.
- Reliance on small teams/individuals leading to a lack of segregation of duties or scrutiny over funds and assets.
- Lack of investment into effective and confidential whistleblowing arrangements.

In many organisations, the approach to considering the risks posed by fraud has been reactive; addressing incidents as and when they arise, rather than proactively managing them. Effective fraud risk management is becoming an increasingly important factor in influencing people's trust and confidence, which are integral to charitable organisations. In addition, the Charity Commission encourages charities to measure how well they are protected against fraud from a regulatory perspective.

Consequently, we are seeing more charities taking efforts to proactively manage fraud risk by implementing and embedding fraud risk management frameworks (Figure 1).

1 The Annual Fraud Indicator May 2016

Figure1. Fraud risk management framework



How might the fraud materialise?

There have been a number of high-profile frauds recently which have resulted in a significant impact on the charity's reputation and ability to deliver on its strategic aims, on top of the direct financial implications.

Common examples include misuse of charity funding and grants, unauthorised fundraising and use of false qualifications/ credentials as part of the recruitment process.

What should Trustees and management do to respond to this risk?

Trustees and management are jointly responsible for establishing and maintaining an adequate internal control system. Given the potential reputation and financial impact of fraud on charities, it's important that an appropriate fraud risk management framework, such as that set out in Figure 1, is implemented.

In summary, the fraud risk management framework assists organisations in the identification of relevant fraud risks and facilitates the identification and remediation of corresponding gaps in control. The risk assessment can be used to drive the design and development of proportionate policies and procedures and the delivery of risk based anti-fraud training to raise awareness amongst staff and third parties of the threat posed by fraud.

In addition, a strong 'tone from the top' with regards to fraud prevention and detection, is an important part of the fraud risk management framework and helps to maximise the chances of recovery where fraud is committed, and subsequently minimise the opportunities for any recurrence.

Key areas, organisations can focus on in the short term are set out below in a quick 'Anti-fraud Checklist':

	Yes	**Improvement required**
Governance and Leadership		
Individual or committee with designated overall responsibility for the oversight and management of fraud risk	☐	☐
Anti-fraud strategy document which sets out key priorities/aims for the organisation	☐	☐
Trustees/staff/volunteers have appropriate skills to competently perform their role and responsibilities	☐	☐
Risk assessment		
Risk assessment performed that enables the charity to accurately identify and prioritise fraud risks faced	☐	☐
Policies and procedures		
Clear policies and procedures across all high risk areas of your charity, which consider fraud risk	☐	☐
Internally published anti-fraud policy	☐	☐
Fraud response plan in place to enable any incidents to be dealt with appropriately	☐	☐
Due diligence		
Trustee/staff/volunteer/contractor background and recruitment checks undertaken	☐	☐
Proportionate third party financial and background checks undertaken on a regular basis	☐	☐
Training and communication		
Focused communications for high fraud risk areas of operation	☐	☐
Key elements of anti-fraud policy publicised	☐	☐
Monitoring and review		
Established and documented process for monitoring and enforcing compliance with the charity's procedures (three lines of defence)	☐	☐
Robust and independent whistleblowing function (channel, investigation and resolution) in place	☐	☐

Iberdrola: Business as usual?

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The case of Iberdrola Immobiliaria Real Estate Investments (C-132/16) turned heads recently in the world of VAT – if Iberdrola could not recover the VAT incurred in redeveloping local infrastructure that would allow future real estate development, what impact might this have on the obligations imposed on developers by planning authorities across the United Kingdom?

For housing associations and charities involved in building developments and relationships with local authorities this could have an impact.

Iberdrola acquired land in a Bulgarian holiday village with the intention to construct holiday flats. As local infrastructure was unable to support the planned development, Iberdrola entered into a contract with the municipality to reconstruct a waste-water pumping station free-of-charge, increasing the number of properties it could service in the village. Iberdrola's project would be able to proceed as a consequence. The Bulgarian tax authority sought to block Iberdrola's reclamation of the input VAT it had incurred. Iberdrola appealed, and the case was ultimately referred to the Court of Justice of the European Union.

At issue was both the fact that Iberdrola provided the reconstruction services free-of-charge, and the link (or lack thereof) between Iberdrola's costs and its eventual taxable supplies. Basic principles of VAT law are that VAT is wholly recoverable on costs where it can be directly attributable to a taxable supply, and partially recoverable when that cost forms a general overhead. Problems arise in circumstances where a link cannot be established between cost and business activity, or where costs are attributable to services provided without any consideration (i.e. some form of payment by the receiving party), as was the case here: the municipality did not in any way reimburse Iberdrola for its expenses.

The release of the opinion of Advocate General J. Kokott on 6 April 2017 garnered considerable attention; even if Iberdrola could draw a link between its construction of the waste-water pumping station and its subsequent taxable business activities, the fact that the services were provided free-of-charge disqualified any chance of input VAT recovery.

VAT professionals immediately queried whether this treatment might apply to Section 106 charges in the UK. If a Local Authority requires that a developer build a school as a pre-requisite for planning permission, can VAT incurred in meeting that obligation be attributed to the subsequent development activities?

The final judgment, released on 14 September 2017, diverged from the Advocate General's opinion – infrastructure works were a necessary precursor of Iberdrola's subsequent economic activity. There was a direct and immediate link between constructing the required pumping station and completing the development. However, the judgement also states that any element of the supply which went beyond what was directly attributable to Iberdrola's outputs (i.e. the municipality's use of the improved capacity of the infrastructure to support land that isn't Iberdrola's) would block corresponding input VAT, and so Iberdrola's recovery would have to be apportioned to reflect other parties' use of the pumping station!

Whilst this potentially leaves the door open for HMRC to start querying Section 106 costs, developers could continue to argue that Section 106 payments are an ***obligation*** imposed under UK law, and a restriction of corresponding input tax would represent a huge cost to the entire industry. Given current debates around housing stock in the UK, HMRC would be pursuing a particularly unpopular battle in seeking to further add to costs borne by developers.

It's business as usual in the short-term, but clarifying discussions with HMRC may be on the table. Watch this space.

Reporting on the male female divide

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The BBC hit the headlines this summer, when it published, for the first time, the salaries of its highest paid stars. We consider the presence of women on charity boards and in senior positions and look ahead to the gender pay reporting that is required by employers with over 250 employees next year.

Board and senior management representation

The corporate world

The Equality and Human Rights Commission inquiry[2] examined how boards were performing on gender diversity in the light of the October 2015 statement by Lord Davies that the FTSE 100 as a group had met a target of 25% female board members, the FTSE 250 was close to 20% and the FTSE 350 average as a whole was 21.9%. The report found wide variations in performance with most companies still falling below the 25% level. Focussing on just executive director roles, nearly three-quarters of FTSE 100 companies and 90% of FTSE 250 companies had no female executive director in 2013/14. The Female FTES Board report, published[3] in July 2016, showed that female representation in the FTSE 100 was stable at around 26%. 20% of companies had female executive directors and all companies in the FTSE 100 had at least one female director. 19% of companies had at least 33% female directors (the 2020 target). FTSE 200 averages were lower in every category.

The voluntary sector

Looking at the position in the voluntary sector, we have included questions in our survey of trustees' annual reporting[4] on gender diversity in trustee board composition and key management personnel. Of the 50 trustees' annual reports covering year ends from December 2015 to March 2016 that we sampled 85% of charities gave sufficient detail in their reports to identify male and female trustees. The highest board representation was 87% women and the lowest reported was no women. The median was 33% women. Figures 1 to 4 show the overall result and those results broken down to reflect charities in the top 100, those ranking 101-200 and those 201-1000 based on the top 3000 charities by income published by CharitasData.

2 An Inquiry into fairness, transparency and diversity in FTSE 350 board appointments – Equality and Human Rights Commission March 2016.
3 The Female FTSE Board report 2016 – Cranfield University School of Management, Queen Mary University of London and the City University London July 2016
4 Challenges and uncertainties: surveying trustees' annual reports – Deloitte October 2017.

Almost 60% of charities in the top 200 have a board where 40% or more of its members are women compared with 23% of charities ranked 201-1000.

Figure 2. Female Trustees from all charities surveyed giving sufficient information

Percentage of women on the trustee board

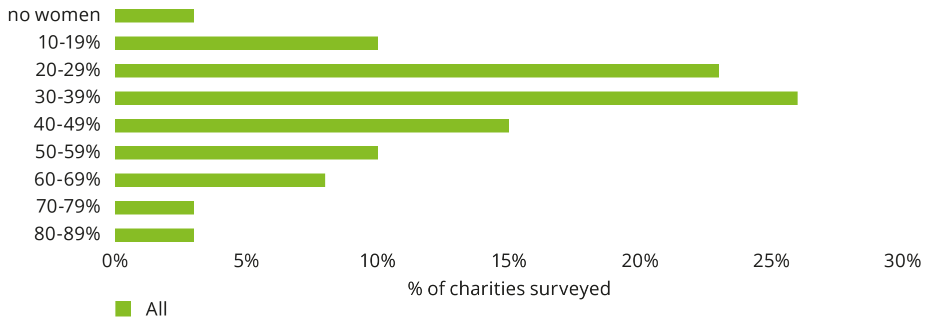


Figure 3. Female Trustees from top 100 charities surveyed giving sufficient information

Percentage of women on the trustee board

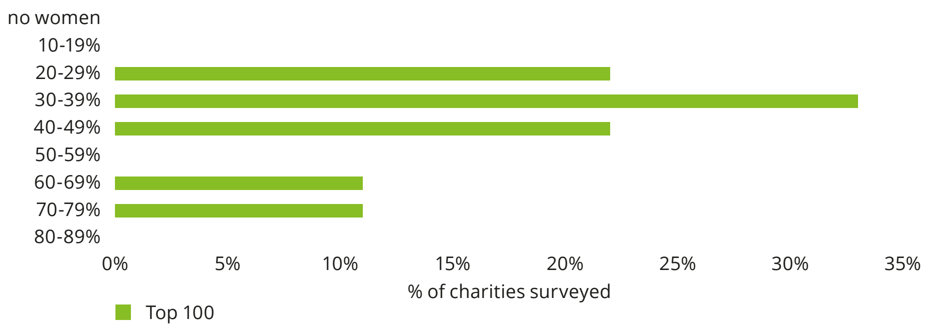


Figure 4. Female Trustees from charities ranked 101-200 surveyed giving sufficient information

Percentage of women on the trustee board

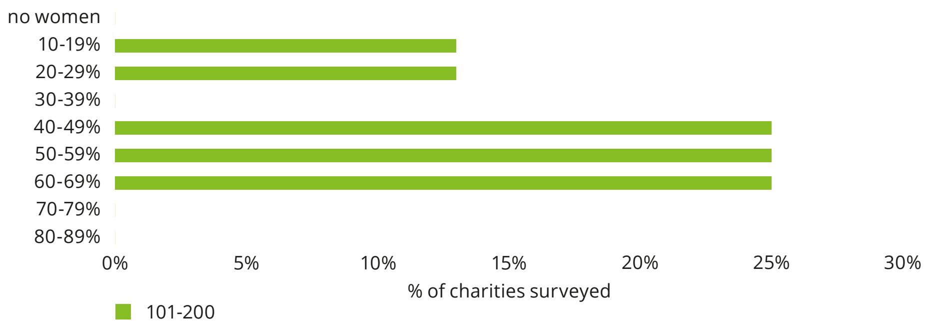


Figure 5. Female Trustees from charities ranked 201-1000 surveyed giving sufficient information

Percentage of women on the trustee board

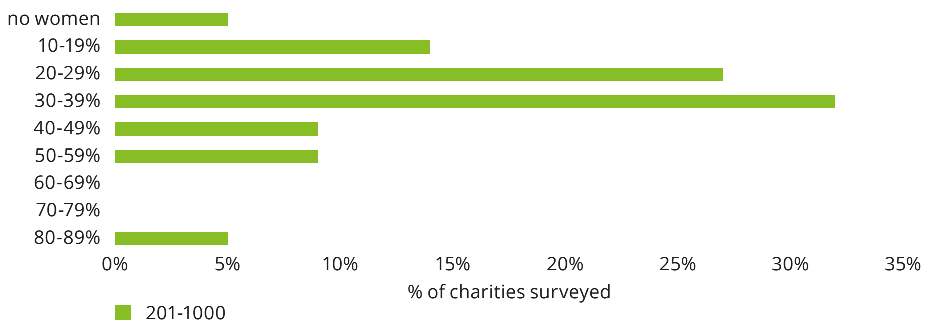


Figure 6. Female key management personnel from all charities surveyed giving sufficient information

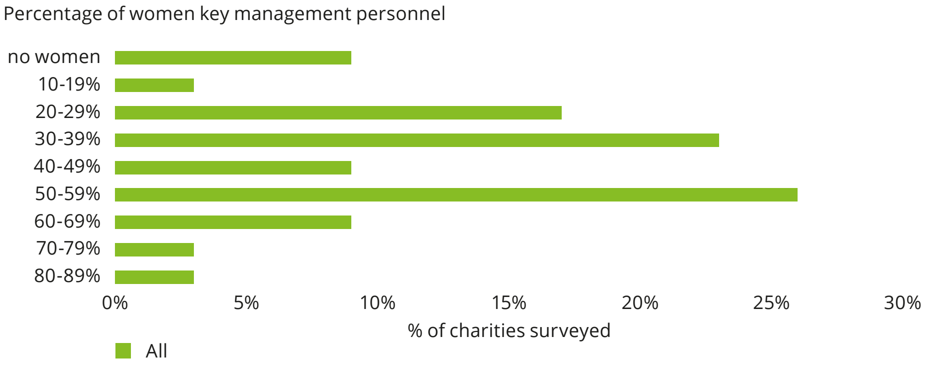


Figure 7. Female key management personnel from charities ranked in the top 100 surveyed giving sufficient information

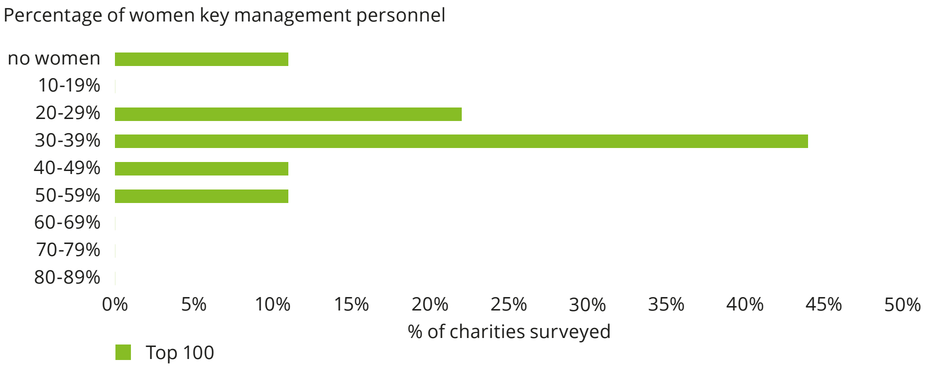


Figure 8. Female key management personnel from charities ranked 101-200 surveyed giving sufficient information

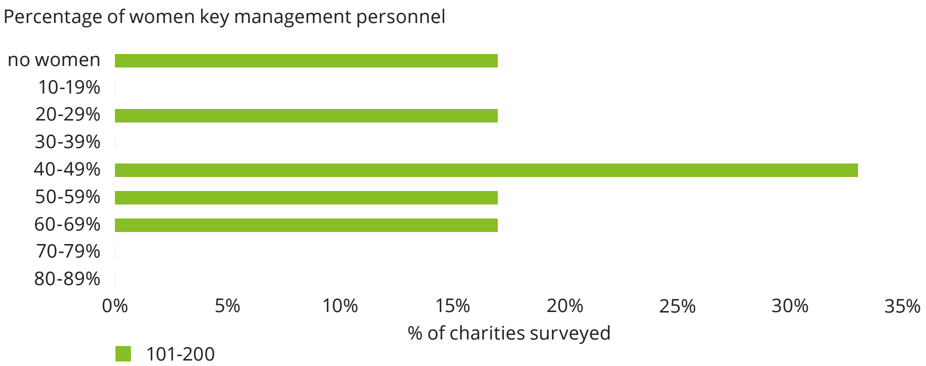
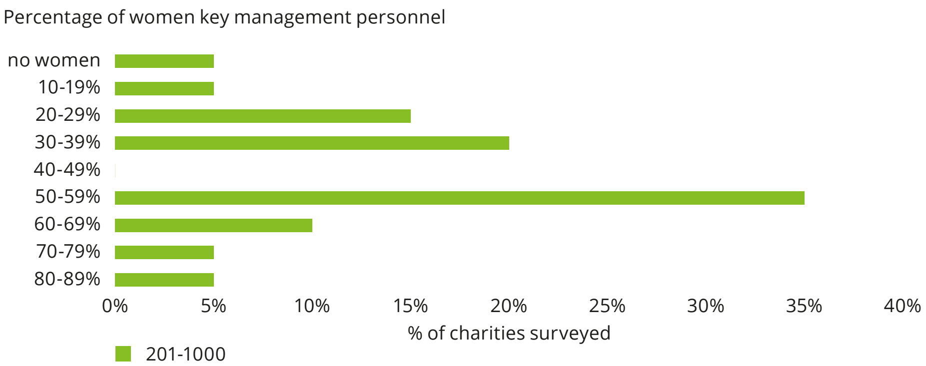


Figure 9. Female key management personnel from charities ranked 201-1000 surveyed giving sufficient information



In the corporate sphere the number of female executive directors is lower than representation on Boards as a whole. To understand the equivalent position in charities we have looked at the disclosure of key management personnel. The highest female representation amongst key management personnel was 80% and the lowest none. The median was 38% and whilst those charities in the 201-1000 ranking had the lowest female representation at Board level they had marginally more than those ranked in the top 200 in key management positions.

The gender pay gap

The gender pay gap is different from the right to equal pay. It is unlawful to pay men and women unequally where they carry out the same jobs, similar jobs or work of equal value. The gender pay gap shows the differences in the average pay between men and women.

Publishing the gender gap

Although current trustees' annual reporting requirements include disclosure about key management pay in aggregate these do not allow the reader to draw any conclusions on a gender pay gap. However regulations on gender pay will require charities with over 250 employees to publish information on the gender pay gap by April 2018.

In October 2016 the Office of National Statistics (ONS) published its latest data on the gender pay gap which found that the gender pay gap (for median earnings) for full-time employees decreased to 9.4% from 9.6% in 2015 and the gap for all employees (full-time and part-time) also decreased from 19.3% in 2015 to 18.1% in 2016. The differences between the two measures reflect the fact that part-time workers tend to be paid a lower hourly rate than full-time workers and that there are more women in part time jobs[5]

What is required?

Depending on the nature of the organisation the requirements may be quite complex and will apply to all employers with over 250 employees. Guidance has been published by the Government Equalities Office and ACAS to support employers in preparing their calculations[6]. The first data point is 5 April 2017 and voluntary sector organisations have until 4 April 2018 to publish their data.

The six basic calculations:

- your mean gender pay gap
- your median gender pay gap
- your mean bonus gender pay gap
- your median bonus gender pay gap
- your proportion of males and females receiving a bonus payment; and
- your proportion of males and females in each quartile band.

Confirmations and explanations

Employers will have to provide a written statement confirming that the calculations are accurate, which must be signed by an appropriate senior person. Charities will need to decide who will provide that confirmation and what support they require over the information produced to make that statement. Information must be published on the organisation's own website and uploaded to the government website. Currently about 1%[7] of estimated employers covered by these regulations have uploaded data. A narrative around the data reported is likely to be necessary.

Some points to note

The data to complete calculations may not be easy to extract and therefore we would encourage organisations to get to grips with the requirements to avoid a last minute rush to the deadline.

The list below is not exclusive but highlights some of the points that should be considered.

- Each part time worker will count as one employee for gender pay reporting purposes. This may be an issue for employers used to reporting and monitoring full time equivalents.
- Ordinary pay includes basic pay, allowances, pay for piecework, pay for leave and shift premium pay. It only includes money payments so anything that is not money (such as benefits in kind or securities) is excluded.
- Where allowances are paid for core duties or regular amounts for example for being on call they should be included in ordinary pay. One-off recruitment or retention allowances that are in the nature of a bonus should be included in the bonus calculation.
- Ordinary pay does not include overtime pay, redundancy pay, pay related to termination of employment or repayments for authorised expenses.
- The employer should use the gross pay after any reduction for a salary sacrifice scheme (including where an employee contributes to a pension by means of a salary sacrifice scheme).
- Bonuses relate only to those actually paid and therefore received by the employee in the period which may therefore differ from the accounting treatment of bonuses.

5 Annual Survey of Hours and Earnings: 2016 provisional results – Office for National Statistics 26 October 2016
6 Managing gender pay reporting – ACAS, Government Equalities Office March 2017
7 Financial Times: Gender Pay Gap 27 September 2017

- The value of bonuses paid in securities should be included at the time when the employee incurs a charge to income tax. If securities do not give rise to a charge to income tax at all, they will not be included in bonus pay.

- Employers must identify both relevant employees and relevant full-pay employees for the calculations. To be a full-pay relevant employee, the employee must be paid their full usual pay during the pay period in which the snapshot date falls. For example, an employee taking paid annual leave during the pay period would still be considered a full-pay relevant employee, but an employee on unpaid leave or taking an unpaid sabbatical would not. Employees being paid statutory sick pay or statutory maternity pay which is less than their usual pay would also not be full-pay relevant employees. All such employees would still be relevant employees for the bonus calculations.

What is required?

Now is the time to make sure that a plan is in place, firstly to extract the data, which could be particularly complicated for organisations with a large number of variable contracts such as those delivering social care, but secondly and importantly that time is given both to check the calculations and interpret the results. Meeting the deadline and the legal requirements are key, but explaining the statistics and telling the story will be fundamental to the organisation's reputation.

Notes

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