Grant Thornton

2025

Charity sector development report

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Foreword

Financial sustainability, modern ways of fundraising, and diversification of revenue are some of the sector buzzwords for 2025. Charities continue to be asked to do more with less, in an environment where grants and contracts no longer fully cover costs. Our 2025 charity development report considers sector risks, financial reporting and regulatory updates, and this year includes commentary on VAT cases and employment services consideration.

Diversification of charitable income is increasingly important: on the whole, fewer people seem able to donate cash, and grants are failing to keep up with inflation. Corporate partnerships seem more appealing, and the use of digital platforms is a growing area of success with younger generations.

Artificial intelligence (AI) remains an area of hopeful curiosity across sectors. As organisations grapple with security and data protection, there's some appreciation that AI could transform some functions, such as report writing or the automation of time-consuming tasks.

Charities are facing a challenge in recruiting and retaining suitable trustees, those with suitable skills and/or experience. A desire for trustees with requisite skills, lived experience, and diversity (of age or ethnicity) means that a 'ideal board' can be hard to achieve. At the end of 2024, Grant Thornton hosted a roundtable on the challenges around charity governance which we explore in this article, and we develop some of those themes in our sector report.

Legal and regulatory frameworks have changed for this reporting cycle. Companies Act thresholds change from 5 April 2025, which should reduce the administrative burden on smaller and medium-sized companies and charitable companies. The new Economic Crime and Corporate Transparency Act requires organisations to have 'reasonable' procedures in place to prevent fraud, which may mean that some charitable companies need to review their fraud policies and processes.

The triennial review of FRS 102 brings with it an updated Charities SORP (currently out for consultation until 20th June 2025), providing guidance or charities in key reporting areas – most notably leases and revenues which change significantly under the revised FRS 102 and applies from 1 January 2026. This year's sector report also includes reminders on fundraising disclosures – an area of financial reporting which can often be overlooked.

Defined benefit pensions remain an area of focus, especially where, as has been seen in recent reporting periods, there's a net surplus to report. A number of high-profile court challenges around pension schemes have also impacted financial reporting requirements.

The most recent Budget brings many challenges for charities, especially around employee costs and employee benefit packages. For some charities, redundancies may be an unpopular, but needed, course of action. We explore pensions, other employee benefits, and managing staff risks later in this report.

We hope you find this publication informative and if there are any matters that you would like to discuss further, please don't hesitate to get in touch with your Grant Thornton contacts.

Harriet Taylor-Raine
NFP Technical Manager

Sector risks

Diversification of revenue

In an unpredictable economic environment, UK charities are faced with the challenge of maintaining sustainable funding. While traditional funding sources like grants and donations remain critical, the changing landscape of giving, along with new digital opportunities, has made it important for charities to consider diversifying their revenue streams. By doing so, organisations will reduce their financial risk and also enhance their resilience, expand their donor base, and tap into new revenue channels.

Charities traditionally relied on a limited number of revenue streams, which included individual donations, government grants, or fundraising events. However, economic uncertainty, changes in donor behaviour, and the increasing cost of living have made many of these funding sources less reliable. Diversifying revenue enables charities to be less reliant on any single source of income, ensuring greater financial stability and allowing organisations to achieve long-term goals. The challenge, however, lies in identifying and implementing effective diversification strategies.

The rise of digital platforms has created new opportunities for charities to engage with people and raise funds. Online donations, crowdfunding campaigns, and subscription-based giving have become powerful tools. Social media platforms like Instagram, Facebook, and TikTok also enable charities to create viral campaigns that reach a global audience. Charities could also consider partnering with influencers who already have large followings on social media and streaming services. Building an engaging and consistent profile on every social media platform is time consuming and expensive, but if you partner with someone that already has a relevant following you can leverage that to introduce your cause to them. Adopting digital fundraising platforms can help charities target younger donors who prefer online donations. This shift has the potential to expand donor reach, especially if charities are active on platforms like Crowdfunder, Just Giving, or GoFundMe. There's also evidence that Gen Z may be more willing to donate time and volunteer in charity work than donate money. Charities that utilise volunteering can leverage off this to save cost which will ease the pressure on generating more income.

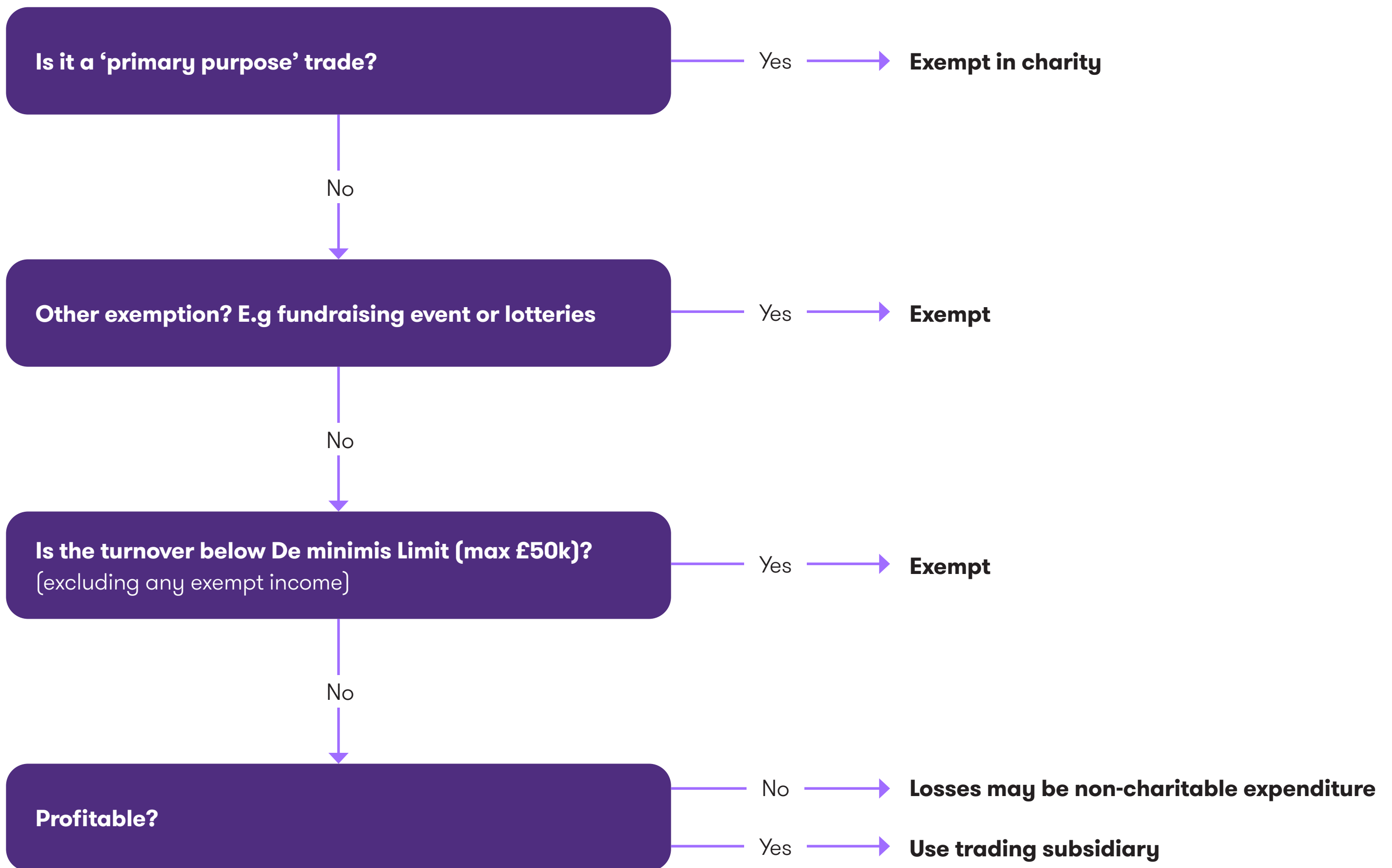
While corporate partnerships have existed for many larger charities, there are growing opportunities for smaller organisations to secure funding through collaborations with businesses. These partnerships can take the form of sponsorships for events, cause-related marketing campaigns, or even long-term partnerships where a company commits to regular financial support. Charities should look to align with businesses whose values reflect their own. Corporate social responsibility initiatives have become an important focus for many companies, and creating strategic partnerships can be mutually beneficial. Many companies offer employee matching gift programmes or encourage staff to volunteer, which can provide both direct funding and a larger volunteer base for events.

Many charities are looking at how they can generate income through product sales and providing services. This might include running charitable shops, selling branded merchandise, or offering fee-based training, health tests, consultancy, or workshops. These ventures allow charities to generate income that can be reinvested into their mission, while providing valuable services to their community. With the rise of online shopping, selling branded products can be an additional source of revenue while raising awareness for the charity.

While diversifying revenue is important, charities must be mindful of the challenges that come with it. With inflation rates and the cost of living continuing to rise, many traditional donors may have less disposable income to contribute. Charities must remain flexible and adapt their strategies to suit changing economic conditions. Diversification requires time, effort, and often upfront investment, which can be a challenge for charities with limited resources. A clear strategy and targeted efforts are key considerations to ensure charities don't overcommit resources.

Charities must be aware of the tax implications of diversifying their income. For example, revenue from the sale of products may be subject to taxation, and sponsorship income which is received in return for something back to the sponsor would represent non-charitable revenue which will have tax consequences. Charities must be structured carefully to ensure compliance with tax laws. When a charity's taxable trading activities aren't covered by one of the charity tax exemptions the trustees need to consider setting up a trading subsidiary. The decision process can be summarised by this decision tree:

Trading decision tree for corporate tax



As UK charities face a changing financial landscape, the need for revenue diversification has never been greater. By embracing digital fundraising and exploring corporate partnerships, charities can build more resilient financial foundations. However, this diversification must be strategic, ensuring that new income streams align with the charity's mission, values, and long-term goals. As new revenue streams could be non-charitable, the tax effects should be assessed to ensure compliance with tax laws and regulations. With careful planning and the right support, charities can't only withstand economic uncertainty but thrive in a changing environment.

Sources and articles used: [10 Ways Charities Can Diversify Their Income Streams in 2024 | Torchbox]

Artificial Intelligence (AI)

Over the last few years, there's been more of a focus on artificial intelligence (AI) and how it can impact individuals and businesses including the charity sector.

The Oxford Dictionary defines AI as 'The capacity of computers or other machines to exhibit or simulate intelligent behaviour; the field of study concerned with this. In later use also: software used to perform tasks or produce output previously thought to require human intelligence, esp. by using machine learning to extrapolate from large collections of data'.[1]

Use of AI in charities

The 2023 Charity Digital Skills report[2] suggested that 35% of charities were already using AI for certain tasks and that a further 26% had plans to do so in the future, therefore highlighting that charities are embracing the benefits which AI could bring to them.

New Philanthropy Capital (NPC) noted that the majority of uses for charities, involve content creation. Generative AI may help you to produce ideas and save time as a 'first draft generator' for anything from; blogs, to campaign emails, to grant-reports and presentations[3].

As executives, management and trustees, before using AI you should ensure that all individuals who would be using it fully understand what AI is, how it works (at a basic level) and what it should / shouldn't be used for.

Although AI has a number of advantages such as supporting teams where there may be gaps in knowledge or skills, thereby freeing up time which could be spent on more strategic matters, there are also risks with its use given the way AI is built.

Research undertaken by Charities Aid Foundation[4] showed that charities will need to be transparent with their donors as only 13% of donors would pay 'not much' or 'no attention' to what a charity they supported said about AI. Donors want to understand how AI will be used. Communicating details and policies around AI will aid this process and may lead to increased engagement with donors.

Risks of using AI

Some common risks are:

- Lack of appropriate IT policies in place to explain how AI should be used and when it is appropriate to use with regards to your charity
- AI learns from the information which is input and therefore consideration needs to be given as to the data input and whether it is appropriate and in accordance with regulations such as GDPR
- The information input into AI isn't always secure (when using external programmes such as Chat GPT) and may be available to others, therefore consideration needs to be given to the security level of the data
- Inaccurate information can be given by AI as it's only as accurate as the data which they have available and therefore human interaction is needed to ensure that it's appropriate and accurate.

How Grant Thornton can help

Effective implementation and management of AI systems can transform a business and unlock new possibilities, while also ensuring compliance with industry frameworks and shifting regulations.

Embedding AI systems into your business can help you maximise commercial returns and operational efficiencies, but increased scrutiny means it requires support across risk management and assurance. Without appropriate guardrails, organisations may breach privacy and ethical standards, potentially resulting in reputational damage and fines under breaches of regulations, eg GDPR or the EU AI Act.

If you need further support on how AI can assist your charity, please contact Alex Hunt, Head of Data Analytics and Automation

1 Artificial intelligence, n. meanings, etymology and more | Oxford English Dictionary
2 Charity-Digital-Skills-Report-2023.pdf
3 AI for charities: What you need to know
4 AI for charities bringing donors and staff on the journey| CAF

Bringing governance back into focus

Charities are known for and expected to make an impact in the work that they do, and over the last few years there have been increasing levels of expectations placed on all organisations (not just charities) in respect of the impact and meaningful change they're making. In recent years, public focus has shifted to demand more openness, transparency and progression in respect of what has become known as 'ESG' – but interestingly enough, the majority of the attention has been directed at the 'E' (Environmental) and the 'S' (Social) elements of the acronym. This is perhaps to be expected given the introduction and continuous development of regulation and legislation in respect of reporting on pay gaps, diversity, carbon emissions and similar topics. However, there's very little open discourse about how the 'G' (Governance) fits into this picture.

The irony is that in reality it's very difficult to create meaningful Social and Environmental impact as an organisation if the Governance structures aren't there to support the activities being undertaken. Taking that into consideration, perhaps it's now time to bring Governance back to the forefront of the conversation, and to start asking the bigger questions; what do organisations need to have in place in order to support effective governance and achieve their charitable objectives, what are the barriers to realising this and what more can be to done to make this more attainable?

What is governance?

In order to be able to create an effective governance structure, it's important to be able to define what governance means to an organisation. This is a more complex task than it might seem at first glance, as governance is wide-reaching and impacts everything in an organisation – and every organisation will have a different idea of what governance means to them. Charities, by their very nature, have more complex structures in place and will be beholden to more stakeholders than corporate entities including beneficiaries, donors / funders, suppliers, employees, volunteers, regulators, and the general public. This means that there are a significant number of different needs and expectations that will all need to be simultaneously met, and good governance ought to start with an understanding and appreciation of this fact.

In short, Governance is the glue that holds an organisation together, so if this isn't structured properly then it can create further challenges down the line as the organisation works towards its charitable objectives and mission.

What makes governance effective?

Given the multi-faceted nature of governance, there's obviously not going to be a single answer or structure that will suit every single organisation. However, there are some common themes that can be drawn out when observing organisations that are operating effectively (or at least understand what they need and are on that journey towards effective governance). Some factors might be considered obvious, such as ensuring that you have the right mix of skills on your board; it's imperative to ensure that those governing the organisation know how to navigate key legal, financial and people related issues. There's also evidence that increased diversity of gender and race in the governance structure greatly improves its effectiveness. Decision making might seem easier on the face of it if everyone looks the same, sounds the same and shares the same experiences and opinions, but is this really the most effective way to run an organisation? Research suggests not, with more diverse boards bringing in different perspectives and experiences enabling more holistic and well-rounded risk assessments – and therefore better informed decision-making – as well as encouraging a greater level of critical thinking and empathy within the board and organisation.

Having a good mix of skillsets is one way to 'balance' the board, but there's also a more granular consideration that needs focus. Trustees have a statutory duty to the organisation they govern, which should always be at the forefront of their minds when acting in post and making key strategic decisions. Such decisions can only be made with access to relevant information, and with an appropriate level of scrutiny over that information. It's therefore important that trustees consider what information they need in order to perform their role effectively and to balance this with the level of detail they may want. Equally, when preparing papers for board meetings and similar committees, management should be mindful of only presenting information that's relevant to the decision or discussion required and avoid providing information for the sake of it. In making sure that board papers are as succinct as possible (and providing them to trustees far enough in advance to be able to properly absorb and consider the information and potential decisions required of them), trustees will find themselves in a position where they aren't distracted by unnecessary detail.

Other factors may seem less obvious but still hold equal value – it's all well and good to have someone who knows how a set of financial statements is put together but consider whether they have knowledge or experience of the issues that the organisation seeks to address, or the community it serves. There's an argument to suggest that diversity isn't just about race, or gender, but should be extended to include sexuality, socio-economic background, geographical location and even lived experience. How better to understand the issues that your organisation is seeking to address than to have someone who understands them and has first-hand experience of them?

There are a lot of questions that organisations should be asking themselves when considering what the 'ideal' board (and therefore governance) structure should be – and like all things, it should be about balancing the different needs and goals of the entity and its mission.

The 'idealboard': merit over metrics

The current representation and perceived culture of an organisation is arguably one of the most important aspects to any potential trustee. They will – rightly or wrongly – make judgements and decisions about organisations on the basis of what they can see at face value, so being able to accurately demonstrate your organisation's culture and commitment to that culture is key. Even if the organisation hasn't yet achieved its desired governance structure or goals, being able to demonstrate its commitment to that journey will go a long way to attracting the right sort of candidates.

One thing that's really important for organisations to keep in mind when looking to build their ideal board is the reason that they're looking for someone of a particular skillset, diverse characteristic or experience. This requires an organisation to be really honest with themselves – is it because there's a genuine gap to be filled or is it because the organisation is looking to meet a desired level of diversity? Organisations should be mindful that they're not seeking to appoint trustees purely on the basis of achieving a certain level of diversity or representation. Appointments should always, first and foremost, be made on merit and not for the sake of a metric.

What are the barriers to 'good governance'?

This is a question (among others) in which the Association of Chairs (AoC) is seeking to gain further understanding, having launched a consultation in January 2025 on this very issue.[5] It's likely no surprise that there's a trustee diversity issue, with Inclusive Boards indicating in their most recent Inclusive Governance Report 2022[6] that gender and racial diversity in boards has fallen behind their more corporate equivalents (for example 29% of charities have all white boards compared to 4% of FTSE 100 boards). This issue was further echoed in the National Council for Voluntary Organisations' recent report, Understanding Trustee Recruitment and Retention Challenges[7], issued during Trustee Week in November last year. As the reports suggests, it can't be for lack of trying to improve the levels of diversity – after all, the very nature of the work that charities perform puts them at the forefront of making positive social change – so the big question is what prevents an organisation from getting the right people onto their board?

Much like there's no singular structure for effective governance, there's no single answer to this issue. There are many factors that may increase the challenges in getting people with the right experience and skill into an organisation. Some of these factors may be down to the individual organisation itself, while others are more systemic. The AoC consultation seeks to understand some of these more systemic issues, which include financial and time barriers, the lack of profile for trustees or recognition of the benefits of their work, the lack of support or 'learning culture', and whether or not a wider body of support and regulation for charity infrastructure and governance is needed. The consultation closes at the end of April 2025 and is open to all practitioners and those with experience in the sector. These are big questions, indeed, but ones that certainly need bringing into the open and warrants discussion and thought.

It isn't just about the big questions, though. An organisation itself can play a part in addressing these points immediately by making seemingly small changes to the way it presents itself to the wider public. Recruiting for the right people is always going to be challenging but if it's proving difficult to even get the right applications through the door, let alone appoint a suitable candidate, then organisations should start to look inward. Consider what the public sees when they come across the website or a vacancy posting. It's important that organisations are brave enough to ask the difficult questions of themselves and to make positive changes if needed. Such changes could be as simple as revisiting the language and focus of vacancy postings; is there the right level of focus on drawing out the kind of people you wish to attract or is it reduced to a cursory sentence at the end of a lengthy job description listing ten different 'must-have' skills? Is the information about the organisation, its structure and its board accessible enough and does it give an accurate representation of its culture? If there are changes that an organisation needs to make then it's vital that they accept the importance of such change and embrace it no matter how challenging it may seem at first.

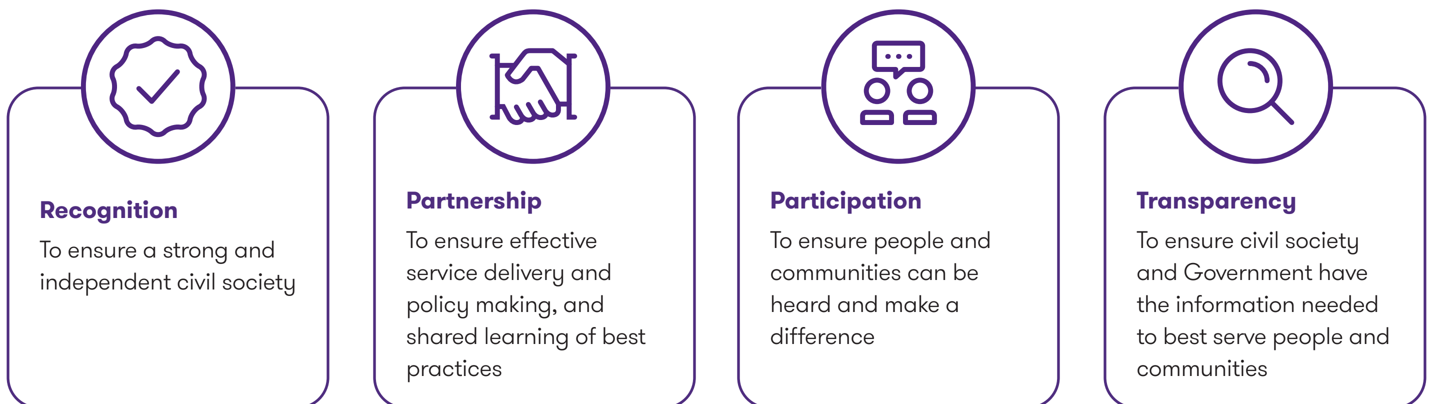
All in all, there are going to be many barriers to achieving that 'ideal' governance structure but as the adage goes, every journey begins with a single step. The most important question that organisations need to be asking themselves is what that first step needs to be and then have the courage to take that step forward.

5 Charity-boards-and-trustees-consultation-document-January-2025.pdf
6 Charities Inclusive Governance Report 2022 - Inclusive Boards
7 understanding_trustee_recruitment_and_retention_challenges.pdf

The new Government and charities

In July 2024, Labour won the UK General Election and came back into Government after the Conservatives had been in power since 2010. The charity sector responded positively to the election outcome, especially after the Prime Minister, Sir Kier Starmer, and the new Minister for Sport, Media, Civil Society and Youth, Stephanie Peacock, announced in October 2024 that the Government would launch a new 'Civil Society Covenant,' and with it, "a fundamental reset of the relationship between government and civil society."

The Government has set out its 'Civil Society Covenant Framework' on which the new relationship between Government and the charity sector will be built. The Framework explains four high level principles:



The Covenant is due to be published later in 2025 following engagement with charity leaders and civil society bodies such as the National Council for Voluntary Organisations (NCVO) and the Association of Chief Executives of Voluntary Organisations (ACEVO).

It's important to reflect that a covenant is ultimately an agreement, or a contract. It relies on both parties to act in partnership and 'pull their weight.' While it might be clear what the charity sector can do to improve civil society, it remains to be seen what support and resources the Government will provide.

Regulatory updates

Companies Act thresholds

The Government has published new legislation, The Companies (Accounts and Reports) (Amendment and Transitional Provision) Regulations 2024, to increase the monetary size thresholds for micro, small and medium-sized entities. The uplift in thresholds is part of a drive to cut complexity and reduce the reporting burden on companies. It also accounts for the impact of inflation since the previous thresholds were set in 2013. As this change affects the Companies Act 2006 thresholds, this will impact charitable companies, see below diagram.

For companies moving into the small entities regime, the impact will be significant insofar as they will be exempt from the requirement to have a statutory audit of their annual accounts (subject to implications of group membership) and from producing a Strategic Report. They'll also be able to take advantage of simpler accounting requirements. Those moving to the micro entities regime will additionally be exempt from producing a Directors' Report. However, small charitable companies (those with turnover lower than £15 million) will still be subject to an audit, in line with the Charity Commission requirements. The guidance in the SORP with respect to the annual report will also have to be adhered to.

Those moving from the large to the medium-sized category will be able to take advantage of exemptions from certain Strategic Report requirements, including a statement on how directors have had regard to stakeholder and other interests listed in section 172, CA 2006, otherwise known as the Section 172(1) statement – these are probably ones that we'll see more of – that some of our charitable company clients that are large, actually are only medium sized from April.

While the thresholds for charity audits remain unchanged (income of over £1 million, or gross assets over £3.26 million and income over £250,000), the changes to company thresholds may mean that the burden of preparing full accounts is reduced, particularly for organisations with income lower than £54 million.

	Micro		Small		Medium	
Turnover not more than	£632k	£1m	£10.2m	£15m	£36m	£54m
Balance sheet not more than	£316k	£500k	£5.1m	£7.5m	£18m	£27m
Average employees not more than	10	10	50	50	250	250

The Economic Crime and Corporate Transparency Act 2024 and the Fraud Offence

The Economic Crime and Corporate Transparency Act 2023 ('the Act') received Royal Assent in October 2023. It's a significant piece of legislation and has ramifications for all areas relating to economic crime. There are many changes arising from the Act, helping to strengthen law enforcement and expand the tools necessary to avoid, detect or prevent economic crime. This includes changes to the Proceeds of Crime Act and Suspicious Activity Reports (SARs); changes to agencies (such as the Serious Fraud Office) enforcement and investigative powers; the ability to confiscate, seize or freeze crypto assets, and changes to the Solicitors Regulation Authority.

There are three further areas of the Act which are expected to have significant impacts on both corporate and charitable organisations alike:

Companies House reforms

Companies House (CH) is thought to be quite 'passive' and acts very much as an online filing system, with very few powers for scrutiny over any of the information supplied to it. Therefore, this is inconsistent with the need to 'crack down' on economic crime, as the regulator doesn't currently have any strong oversight powers. Examples include where company directors die and their details are still held at CH, or multiple residential addresses are incorrectly registered as company addresses. The Act fundamentally changes the role of CH to an enhanced regulator.

CH now has sweeping new powers to query information that it receives, especially where it's inconsistent with existing information held. It can also request additional information, as required. This should mean that CH data is more accurate and reliable. In addition, the regulator will be able to remove information from the public register, which is incorrect or redundant, without having to apply for a court order to correct the public record.

Corporate criminal liability

The Act creates a corporate criminal liability. A company (or charity) is a 'legal person' in the sense that it can act, it can be sued, or enter contracts, etc. However, the individuals who run or work for that organisation allow it to be a legal person and perform those functions. In terms of criminal law therefore, which individuals are responsible for that company and who's in a position to allow a company to commit an economic crime? The owners? The directors? The employees? The Act states that any 'senior manager' can enable the company to be convicted of an economic crime. A 'senior manager' is defined as someone who plays a significant role in managing or organising, or making decisions about the management or organisation of, a substantial part of the organisation's activities.

The Act also creates the 'failure to prevent fraud' offence. In principle, this is akin to the existing 'failure to prevent bribery' offence which many organisations will be aware of, and the 'failure to prevent tax evasion' offence. This type of offence puts the responsibility onto the EMPLOYER to prevent its employees from committing fraud offences. The law allows for some defences, however. Organisations will have a defence if they have reasonable procedures in place to prevent fraud, or if they can demonstrate to the satisfaction of the court that it wasn't reasonable in all the circumstances to expect the organisation to have any prevention procedures in place. This means that if an employee performs a fraud that benefits the entity, but the entity has reasonable measure in place, that entity won't be prosecuted. Ultimately, it's up to the courts to decide if they did have 'reasonable measures' but the guidance offers a fraud prevention framework based upon six key principles:

Top level commitment

Tone from the top set by directors, trustees, etc, and clear governance procedures on fraud prevention.

Risk assessment

Entity assessment of the nature and extent of the exposure to the risk of employees and others committing fraud, using the fraud triangle (opportunity, motive, rationalisation).

Proportionate risk-based prevention procedures

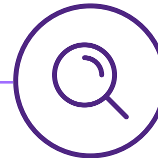
Procedures to prevent fraud by persons associated with it are proportionate to the fraud risks it faces and to the nature, scale and complexity of the organisation's activities. They are also clear, practical, accessible, effectively implemented and enforced.

Due diligence

The organisation applies due diligence procedures, taking a proportionate and risk-based approach, in respect of persons who perform or will perform services for or on behalf of the organisation.

Communication (including training)

Providing and updating training and ensuring policies are communicated and embedded as part of day-to-day work life, as well as having a suitable whistleblowing procedure.



Monitoring and review

Ongoing review of measures, making improvements when needed and learning from mistakes.

Digital filing

From Spring 2025 onwards, the process of making digitally filed accounts will become compulsory over a two to three-year period. This will phase out paper and web-based filing, meaning that organisations will need appropriate software in place to enable a digital filing process and suitably 'tagged' accounts. However, this may have a disproportionate effect on smaller charities, as the administrative burden will become increased, as well as any costs incurred on new software. There may be an opportunity for the Charity Commission and CH to share data, to reduce the burden for charities and make use of information previously submitted.

Charity Commission inquiries

The Charity Commission ensures that the public can support charities with confidence as part of its role as regulator of charities in England and Wales. As part of this role, the Charity Commission will launch inquiries under section 46 of the Charities Act 2011. These statutory inquiries arise when the Commission has been notified of an issue which requires investigation. When a statutory inquiry is opened then the Charity Commission will release a statement to the public. When the inquiry has concluded then a report on the inquiry's findings are published by the Charity Commission which give background to the inquiry, the issue that was under investigation, findings, conclusions, any regulatory action taken and finally, any issues for the wider sector to consider. The Charity Commission published 23 inquiry reports throughout 2024, and the first inquiry report of 2025 was published on 22 January 2025. These reports serve as reminders to those charged with governance of the importance of adhering to the regulations put in place by the Charity Commission for the benefit of their charitable aims.

These statutory inquiries provide valuable points for charity trustees to take away on improving governance, managing risks and protecting the charity assets – all key responsibilities of trustees of charities registered with the Charity Commission. There are common themes arising from the inquiry reports published by the Charity Commission over the past year. Such themes are integral reminders to trustees of the risks that may arise as part of their role and how to mitigate these risks to ensure the objectives of the charities, and the regulations of the Charities Act and the Charity Commission are met. Therefore, we've produced a round-up of the common findings and wider sector considerations from the recently published investigations so they can be in the forefront of the mind of management and those charged with governance.

Governance and governance failures

The findings from the inquiry reports that have been published all stem from poor governance and governance failures of trustees. Trustees have the responsibility of leading a charity and making decisions as to how it's run. Ultimately, trustees must ensure that their charity is carrying out its purposes for the public benefit, complying with the charity's governing document and law, managing resources appropriately and, most importantly, acting in the charity's best interests. A failure to action any of these responsibilities is essentially a failure in performing the duty of trustee.

The governance failures identified by the Charity Commission generally arose under three areas: financial mismanagement, lack of financial controls and failure to safeguard charity assets.

Financial mismanagement

1

Trustees weren't able to demonstrate that payments made to some of the trustees were managed effectively and in line with the requirements of the charity's governing document and internal financial controls. Payments were made to trustees that weren't in accordance with the charity's governing documents and payments weren't approved in accordance with the metrics outlined by the charity's internal financial controls. Trustee payments were also not approved by the remaining trustees who wouldn't benefit from the payment. Conditions must be met before paying a trustee for a good or service.

2

Payments were made to recipients with connections to trustees, including close family members and friends. Such transactions didn't have the proper documentation or explanation from the trustees. These constituted related party transactions, where a clear conflict of interest could be identified, due to the connection of the recipients to the trustees, and no safeguarding actions were undertaken by the trustees.

3

Payments made between trustees and connected bank accounts weren't discussed in the meeting minutes of the charity. The purpose of the transaction wasn't minuted, resulting in a failure to maintain adequate records for such transactions.

4

Charities made unsecured, interest free loans to its subsidiary companies. These loans, which were repayable on demand, weren't formalised by written loan agreements, and there were no records maintained of a former trustee's decisions to make the loans. When loans are made to a charity, one would expect the charity to have receipts and an agreement in place which sets the terms of the loan (amount of the loan, schedule of repayments or date when it should be repaid and any interest to be added). Failure to ensure an agreement is in place, which sets out the loan terms puts the charity's funds at risk. Any organisation or individual that loans money to a charity should appear in the charity's financial statements as a creditor to the charity.

5

Trustees didn't provide effective oversight to address conflicts of interest between companies that were engaged by the charity, of which the charity's trustees were also directors of the other companies. This resulted in a conflict of interest that hadn't been discussed by the trustees and proper safeguards weren't put into place to address the transaction(s) that occurred.

6

Expenses incurred by trustees were reimbursed by the charity, however, such expenses incurred weren't considered to be reasonable expenses. Trustees misused the charity's assets to pay for travel expenditures that were lavish in nature (ie, five star hotels, visits to the spa and luxury food and alcohol) and weren't considered to meet the criteria of reasonable travel and subsistence costs.

Lack of financial controls

1. Trustees had a lack of understanding or disregard of the importance of proper financial management and controls within the charity. Controls weren't outlined or adhered to within the charity, which resulted in the charity's assets being misused or unable to be evidenced that they were utilised in accordance with the charity's objectives.

2. Bank transfer request processes outlined in the charity's financial controls policy weren't followed, and payments, which required signatures of authorised individuals in accordance with the charity's financial controls policy, were made without such authorisation.

3. Audit trails of the charity's records, including financial receipts and payments, weren't maintained and other transactions were unaccounted for without any supporting documentation. Failure of a trustee to show how the charity's funds have been properly applied in accordance with the objectives of the charity amounts to misconduct and mismanagement.

4. Trustees didn't implement a system of internal controls, which meant that there was little evidence of record keeping or authorisation of expenditure. The lack of internal controls resulted in numerous instances of non-charitable expenditure made out of the charity's bank account.

5. Trustees didn't ensure that the charity's accounts and annual returns were filed on time with the Charity Commission and the documents were repeatedly filed late. It's the trustees legal duty and responsibility to file the charity's statutory accounts on time.

A common theme between the lack of financial controls and financial mismanagement results from the trustees not acting in the best interests of the charity. As part of their role, trustees must be identifying and managing all conflicts of interest as they arise, which is why minuting such discussions and following conflict of interest provisions in their governing documents are paramount. These related party transactions result in a mismanagement of charity funds. The Charities SORP (2019) includes a comprehensive definition of related parties. Management and those charged with governance should be considering these related party relationships throughout their tenure. Related parties, any related party transactions and conflicts of interest are all areas that trustees should be considering when they meet, to be able to conclude that any relationships have been appropriately documented, considered by the unaffected trustees, and dealt with in accordance with the charity's governing document. Additionally, management and those charged with governance should be considering such transactions as part of the financial statement preparation process. Related parties and related party transactions were a lengthy topic in our Charity Sector publication, which was published in April 2024, and we encourage readers to revisit that publication to review the article in full to consider any related party risks that may impact your charity.

Failure to safeguard assets

1. Trustees failed to demonstrate that they were acting in accordance with the charity's governing document. Inadequate records were maintained and therefore trustees couldn't explain how the charity's funds were being spent, resulting in failure to ensure that the charity was properly managed and administered.
2. Trustees failed to have trustee meetings at the frequency outlined in charity's governing document. As a result, trustees weren't monitoring and providing oversight of the charity.
3. Trustees didn't have effective and appropriate systems in place to identify and manage the key reputation risks that their charity may face from fundraising. The trustees didn't consider how a charity's donors, supporters and public could view their fundraising approach. Trustees didn't adequately consider the risks associated with fundraising and the impact such risks could have on the charity when working with third parties who were unvetted. As a result, regulations issued by the fundraising regulator weren't followed, and the charity experienced reputational damage.
4. Serious incidents weren't reported to the Charity Commission. These adverse events, which result in significant risk to the charity's beneficiaries, loss of charity's assets, damage to charity's properly, or harm to charity's endeavours or reputation are required to be reported to the Charity Commission immediately.

In order for trustees to avoid the malpractices listed above, it's important for trustees to maintain accurate books and records, which include accurate minute taking that reflects the conversations of which the trustees have engaged in, a thorough process to identify, declare, maintain and keep records of related parties and conflicts of interest, and a policy for trustees which outlines when conflicts of interest normally occur and how to declare the conflicts of interest and what trustees should do about any conflicts. Finally, all trustees must consider the rule outlined in the charity's governing document, the law, and the Chairty Commission to ensure that the trustees are fulfilling their duties.

The definition of related parties is extensive, and encompasses a wide range of persons. We encourage all readers to revisit our April 2024 Charity Sector publication to reread the misconceptions of related parties. The Charities SORP (FRS 102) provides a complete definition of which constitutes a related party, and we encourage those charged with governance to review the definition from the SORP to ensure records of related parties are maintained.

Best practices

The numerous examples outlined above demonstrate the number of ways in which trustees failed to deliver in their role. For those changed with governance to avoid being the focus of an inquiry investigation for any of the reasons above, there are several best practices that charities can implement:

1. Clear governance structure
2. Financial oversight
3. Board training and development
4. Conflict of interest policies
5. Regular monitoring and evaluation
6. Stakeholder engagement

Overall, the published inquiries from the Charity Commission showcase the importance of the conduct of a charity's trustees. Trustees are responsible for governing their charity. As noted by the Charity Commission, "the conduct of trustees are a key driver of public trust and confidence in the charity sector". A trustee is a position of trust. Charity beneficiaries, donors, stakeholders and public rely on the trustees to fulfill their legal duties. It's the responsibility of the trustees to provide the adequate oversight of their charity to ensure that the sector considerations that have been identified in the Charity Commission inquiries are adequately covered through their monitoring and oversight.

Financial reporting, law, and audit

Changes to the Charities SORP (FRS102)

Following the triennial review and issuance of the revised Financial Reporting Standard 102 (FRS102) last year, amendments to the Charities SORP have been expected. Due to be effective for accounting periods starting on or after 1 January 2026, a revised SORP has been issued for consultation in March 2025. While the final version of the SORP won't be released until later in 2025, there are some key areas that are expected to present significant change for charities; namely in respect of revenue recognition and lease accounting.

Now that the consultation has been issued, it's important to consider and prepare for the potential impact of the changes expected. These, along with the overall timetable to the issuance of the revised SORP later this year, are set out below as reminders of the assessments required.

The five-step model for revenue

The revisions to FRS102 in respect of revenue recognition have been made in order to more closely align to the requirements of international financial reporting, meaning that there's a new, five-step model (focused around the concept of a 'contract') to be followed when determining the pattern and timing of recognition of revenues. The five steps are as follows:

1. Identification of the contract in place
2. Identification of the price attached to the contract
3. Identification of separate performance obligations within the contract
4. Allocation of the total contract price to each of the performance obligations identified
5. Recognition of revenue as each obligation is met

This is a process that can be relatively simple to follow in respect of areas such as grants receivable where the concept of a contract and recognising income in line with performance obligations is already common practice. In addition, income sources such as donations and fundraising, income from investments and sale of goods are simple enough that there will unlikely be any further complications. For such sources, the income will be earned at the point of receipt and therefore the recognition of income from these activities won't change.

However, this may become more complex in respect of the more sector-specific transactions such as legacies where the nature of the arrangement and determination of a performance obligation isn't immediately obvious. The very nature of legacies is such that the timing and value of receipt can both be subject to a high level of estimation and judgement.

Eradication of the operating lease

The other big area of change is in respect of the manner in which leases are defined and recognised within the financial statements. It has been widely documented that this is an area that will have a potentially complex impact, particularly on charities with various operating leases.

As with the changes reflected in respect of income recognition, the reporting requirements regarding leases have also been more closely aligned to the international financial reporting standards. This means that the concept of distinguishing (for lessees) between finance leases (predominantly recognised on the balance sheet) and operating leases (predominantly recognised through the SOFA) no longer exists and all leases – with some minor exceptions – being recognised as an asset and liability on the balance sheet going forwards. Measuring the liability may be relatively simple given this will be based upon the payments to be made over the lease term, but determining a value of the asset derived from the charity's right of access (referred to as a 'right of use' asset) will require more consideration and therefore judgement and potential estimation uncertainty.

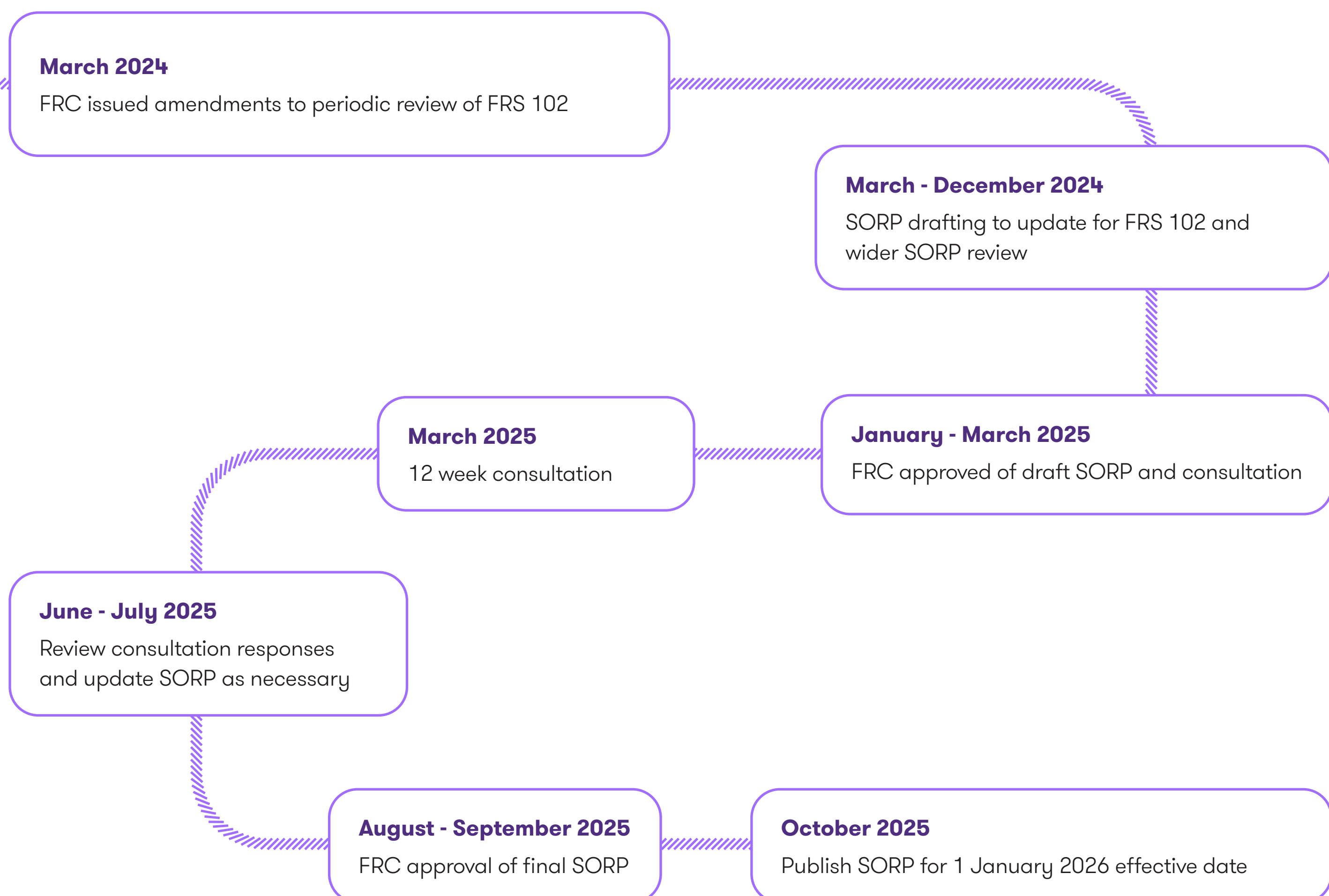
Given that the application of these changes will need to be applied on a retrospective basis, it's important that charities are undertaking a review of their current leasing arrangements now in order to make an assessment of the potential impact of transition. Connected to this point, it should be remembered that a lease liability is considered debt giving rise to finance costs and so key metrics and ratios such as net debt, interest cover and gearing may be adversely impacted. Therefore, it's important to be aware of the potential impact upon any loan covenants with which a charity may have to comply and to assess whether or not the application of the new SORP results in a breach or non-compliance of covenants. Where appropriate, charities should be picking up conversations with their lenders to discuss such impact.

Next steps to the new SORP

In December 2024, an update was posted on the Charity SORP website[8] stating that the SORP-making body (comprised of the Charity Commission, the Office of the Scottish Charity Regulator and the Charity Commission in Northern Ireland) was in the process of finalising a draft of the SORP, which is to be subject to a 12-week public consultation. Once approval was obtained from the Financial Reporting Council (FRC) on the content of the proposed draft, this was released for public consultation. According to the published project timeline (released in both Word and PDF[9]) it's expected that this will be available in March 2025. The consultation will run until 20 June 2025.

Following the consultation period, the SORP-making body will make the relevant updates based on the feedback received before submitting a final version to the FRC for approval. It's anticipated that this will be completed in time to publish the final version of the SORP by September 2025, in time for application to accounting periods starting on or after 1 January 2026.

Charities are reminded that the consultation process is public and therefore is open to any organisation to provide commentary and feedback. This is an important opportunity for trustees to get involved and to help shape the SORP and the guidance contained within, and to ensure that the key complexities and challenges likely to be experienced in its application are properly considered and taken into account. Therefore, trustees are reminded and actively encouraged to participate in the consultation once launched in March this year.



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Getting fundraising disclosures right

Charities and fundraising are two things that tend to go hand in hand and for those charities that engage in fundraising as a main activity, there are a number of obligations and responsibilities placed on them including the reporting requirements set out in Section 13 of The Charities (Protection and Social Investment) Act 2016 ('the Act'). This legislation underpins the content of the Code of Fundraising Practice[10]('the Code') as issued by the Fundraising Regulator, which seeks to set out the standards that apply to fundraising carried out by all charitable institutions and third-party fundraisers in the UK.

The Act requires that any charity engaging in fundraising activities with more than £1 million of income adheres to these reporting requirements, which involves the inclusion of a number of statements within the annual report covering various aspects of the charity's fundraising activity. By following the Code set out by the Fundraising Regulator, charities will be able to demonstrate their compliance with these requirements.

In addition, while charities with income below £1 million have no legal obligations to make such disclosures, it's generally encouraged for these organisations as a means of promoting increased transparency and openness of reporting in the sector.

In July 2022, the Fundraising Regulator performed a review of compliance with these requirements across 198 annual reports for charities with income over £1 million, the results of which were published in January 2023[11] alongside refreshed guidance[12] on the requirements. Alongside this, a full review of the Code was also launched in November 2022, set to span a period of two years. The third and final consultation phase on the revised code concluded with stakeholders on 1 November 2024, with the revised Code due to be issued in early 2025 alongside a timetable for implementation.

Results of the 2022 Compliance Review

This was the third review of compliance to be undertaken by the Fundraising Regulator and, generally speaking, the results demonstrated some improvement since the 2020 review in terms of the quality of disclosure and overall compliance with the requirements of the Act. However, there's still a great deal of improvement to be made, with only 33% being fully compliant with the Act (compared to 21% in the 2020 review). A total of 13% of the reports failed to include any disclosures at all compared to 15% in the previous review.

There was a high level of compliance with requirements (a) to (c) of Section 13 of the Act, with 80% or more organisations including the appropriate levels of disclosure around their fundraising approach and confirmation of the schemes and regulations to which they adhered. There was also an improvement in the number of organisations stating the number of fundraising complaints they had received in the last 12 months, with 69% demonstrating compliance (up from 59% in the 2020 review).

Where there continues to be a need for improvement, however, is in respect of the requirement to include a statement on the monitoring of activities carried out by others on behalf of the charity, which saw a reduction from 41% to 40% across the 144 charities that engaged with external fundraisers. In addition, there was only marginal improvement in the disclosures made around the protection of vulnerable people and other members of the public while fundraising, with 48% (76 reports) including the necessary statements compared to 40% (75 reports) in the 2020 review.

With these headline results in mind and considering the recent review of the Code set to be released for implementation this year, we thought it would be useful to set out a reminder of the key requirements and some indication of best practice for the annual report.

10 Code of Fundraising Practice | Fundraising Regulator
11 The Charities (Protection and Social Investment) Act 2016: an analysis of compliance with fundraising reporting as of July 2022 | Fundraising Regulator
12 The Charities (Protection and Social Investment) Act 2016: Fundraising reporting requirements guidance | Fundraising Regulator

A charity's approach to fundraising

In describing the approach taken to fundraising, charities are required to disclose specifics relating to fundraising activities. This includes the requirement to disclose the type of the fundraising being carried out, such as through a private website, street fundraising or going door-to-door. It's also a requirement to disclose either that all fundraising activity is undertaken in-house (ie, by employees of the charity), or the nature of third parties that have been engaged and involved in the activity on behalf of the charity. Examples of third parties that could be involved in fundraising would include engagement with professional fundraisers or working with commercial participators and volunteers.

Adherence to regulatory requirements and failure to comply

Where a charity (or person acting on behalf of the charity) undertakes activities that are bound by any voluntary scheme for regulating fundraising – or subject to a voluntary standard of fundraising – disclosures are required in order to provide information on these activities and the regulatory requirements placed on the charity as a result.

In making these disclosures, charities are required to set out the schemes and standards for regulating fundraising that they follow, including whether or not they're registered with the Fundraising Regulator. There must be a clear and explicit statement included that either the charity is registered with the Fundraising Regulator, or that it's bound to other voluntary regulation schemes for fundraising. Disclosure of such registrations or similar obligations will extend to any third-party fundraisers and commercial partners with which the charity chooses to engage.

While not mandated by legislation, it's considered best practice to include details of how the charity complies with the Code and how such application and compliance supports the fundraising activities of the charity. Examples of this might include the use of the Code when developing training or supporting volunteer fundraisers.

Where applicable, there's also a requirement to set out details of any failures to comply with applicable voluntary schemes or standards. This includes details of any investigation by (and recommendations from) the Fundraising Regulator. Where such disclosures of compliance matters are required, the minimum information required includes:

- details of the incident (or incidents, if more than one)
- disclosure of which scheme or standard to which the incident relates
- timescales involved in respect of the incident or investigation
- details of the outcome of such an incident or investigation, including any recommendations that may have been made.

In making the above disclosures, it's considered best practice to explain the nature of the compliance issue and the actions that have been put in place to mitigate the risk of future recurrence.

It should be noted that any charities with annual fundraising expenditure in excess of £100,000 is also subject to voluntary annual Fundraising Levy payments and to register with the Fundraising Regulator. This means that, if such levy payments aren't paid, this constitutes a compliance failure for the charity and therefore will require disclosure as such.

While not explicitly required by legislation, where there are no such incidents or investigations to report it's encouraged that a statement to this effect is included.

Monitoring fundraisers

It's a requirement of the legislation to not only monitor the activities of those undertaking fundraising activities on behalf of the charity (whether that be as a third party or under the direct employ of the charity) but to also disclose these monitoring activities in its annual report. Such disclosures will include information in respect of who those fundraisers are, the level of training and support provided to them by the charity, the methods employed by the charity to ensure that standards are maintained and the management of contracts with external fundraisers.

It should be noted that if there are no 'on behalf of' fundraisers from the last 12 months, this fact should be stated within the annual report.

Disclosures relating to complaints

In making this disclosure, charities must include details of the specific number of complaints received in the last financial year. This is an area that historically has been one of the most common omissions. However, it should be noted that missing this detail isn't just a compliance issue, but potentially a reputational one. Omission also puts the charity at risk of appearing to lack the appropriate systems in place to record and report on any fundraising complaints received. If no complaints have been received, then this fact ought to be stated for clarity.

Including this statement can also be considered an opportunity for the charity to explain how it listens to its supporters and reacts accordingly to any feedback received. In some cases, it can be considered informative to include details of the complaints policies in place as well as details of actions taken in response to any complaints received. Doing so can be a means to build public trust in a charity's ability and intention to take complaints seriously.

Protection of vulnerable people

There's a requirement for charities to put appropriate measures and processes in place in order to protect vulnerable people and other members of the public from:

- Unreasonable intrusions on their privacy
- Unreasonably persistent approaches for money or other property
- Placing undue pressure on a person to give money or other property.

Another common area of omission, charities must state what they have done to comply with the Act. In doing this, it's important that the charity's policies and procedures are clearly set out in the disclosure and that this also demonstrates an understanding of the relevant sections of the Code. To that end, the statements included within the annual report should include:

- Details of training provided for staff and volunteers in respect of what vulnerability means and how to recognise and protect vulnerable people
- How such training then translates into its fundraising activities
- How the charity's policies and procedures are monitored and reviewed
- How the risks of fundraising with vulnerable people are mitigated by such policies and procedures.

Pensions

Defined Benefit (DB) pension schemes can be a particularly complex area of charity accounting. For the first time in many years, we've seen some schemes with a net surplus or asset position at the end of the year, and legal challenges have changed the liability position for other schemes. The following section takes you through those key changes and what they mean for your annual financial statements.

Schemes in net surplus

In recent reporting periods, we've seen some defined benefit pension schemes in a net surplus position. If the present value of the defined benefit obligation at the reporting date is less than the fair value of plan assets at that date, the plan is in surplus. Following IAS 19 (Employee Benefits) or Section 28 of FRS 102, an entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it's able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Note that while IFRS preparers must apply 'IFRIC14: IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction,' FRS 102 contains no further guidance on when an entity will be able to recover the surplus either through reduced contributions in the future or through refunds from the plan. In the absence of further guidance, in challenging whether a net defined benefit pension asset should or shouldn't be recognised, it would therefore be acceptable to look to the guidance provided under IFRS Standards, in the form of IFRIC 14.

IFRIC 14 requires that the availability of a refund or reduction in future contributions should be determined on the basis of the terms and conditions of the plan, and any relevant statutory requirements. As a general principle, an economic benefit in the form of a refund or reduction in future contributions is available if the entity can realise that benefit at some point during the life of the plan or when the plan liabilities are settled, even if the benefit isn't realisable immediately at the end of the reporting period.

Available as a refund

IFRIC 14.11 sets out the specified ways in which a surplus may be recoverable in the form of refund and requires that the entity's right to any refund must be "unconditional".

Whether a defined benefit pension surplus is 'available' will depend on a careful assessment of the legal requirements and the rules of the particular plan, which are often codified in a trust deed. Trustees or other third parties may have rights such as the ability to prevent or restrict the payment of a refund, enhance benefits for scheme members or wind up a scheme voluntarily. Usually, the trustees control the surplus funds, and they'll come under pressure to utilise the surplus by either de-risking sooner than planned (ie, taking action to reduce a scheme's exposure to its pension liabilities) or by granting additional benefits to members. Both result in an increased cost, and that cost is met from the surplus funds.

Interpreting whether an unconditional right to a refund of surplus exists can be difficult in practice and requires management judgement.

Under FRS 102 the amount of any surplus should be restricted so that it's no more than the economic benefits that could be realised by the entity, either in the form of future refunds or reductions in future contributions. The position is more complicated under IAS 19 (paragraph 64), where the surplus is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan (the 'asset ceiling').

Reduction of future contributions

In many cases it can be assumed that an entity won't be required to make contributions to a plan in order to maintain a surplus and hence that (provided the plan is open to accrual) it will be able to reduce contributions if the plan has a surplus. Scheme deed and rules, as well as other agreements with the scheme administrator should be carefully reviewed to ensure this assumption holds true.

However, some schemes have minimum funding requirements to improve the security of the post-employment benefit promise made to members of an employee benefit plan. Such requirements normally stipulate a minimum amount or level of contributions that must be made to a plan over a given period. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions. A minimum funding requirement normally stipulates a minimum level of contributions to the plan over a period of time to fund future service cost or past service cost or a combination of both. This minimum funding requirement may limit the ability of the entity to reduce future contributions. If there's no minimum funding requirement for contributions relating to future service, IFRIC 14 states that the economic benefit available as a reduction in contributions is the future service cost to the entity for each period over the shorter of the expected life of the plan and the expected life of the entity.

As noted above, where following IAS19, the amount of any net defined benefit asset that an entity can recognise is limited to an asset ceiling which is the present value of those future benefits. The economic benefit available as a reduction in future contributions, would (ignoring any prepayments) usually be calculated as:

- the PV of IAS 19 future service costs (calculated based on the IAS 19 assumptions used at the balance sheet date) less
- the PV of future service contributions under a minimum funding requirement (minimum funding requirements will state the minimum level of contributions that must be made to a plan over a given period, ie, limiting the ability of the entity to reduce future contributions).

It's important to note that FRS 102 doesn't contain the detailed guidance in IFRIC 14 on the meaning of "reduced contributions in the future or through refunds from the plan" and consequently management will need to develop an appropriate accounting policy and apply it consistently. While many entities may choose to look to IFRIC 14 for guidance, other entities may develop alternative accounting policies and may look to the definition of an asset in FRS 102.2.27 and recognise an asset when it's probable that they'll receive a refund or a reduction in future contributions.

Virgin Media Limited vs. NTL Pension Trustees II Limited

This case has brought some attention due to the potential wide-ranging impact that it may have on DB pension schemes.

In summary, the issue arose when historically amendments could be made to pension schemes. As part of any rule amendments, trustees were required to inform the scheme actuary in writing of proposed rule changes, and the scheme actuary was required to confirm to the trustees in writing that the scheme would continue to satisfy the reference scheme test if the alteration(s) were made. This written confirmation from the actuary is often referred to as a section 37 confirmation. In simple terms, any changes had to be confirmed/ approved by the actuary. In reality, this confirmation wasn't always obtained.

In June 2023, the High Court ruled that amendments to benefits in schemes between 6 April 1997 and 5 April 2016 were void if they were made without the required written confirmation from the scheme actuary. The impact of the decision is likely to be that schemes who made amendments without getting the required certification from the actuary will have additional liabilities. This consequently impacts the financial statements (defined benefit pension obligation) of the sponsoring employer.

Virgin Media Limited appealed this decision. However, in a unanimous decision handed down on 25 July 2024, the Court of Appeal dismissed the appeal and confirmed the original decision in relation to alterations made between 6 April 1997 and 5 April 2013 plus any amendments to future service rights between 6 April 2013 and 5 April 2016 (when salary-related contracting-out was abolished).

At this point in time the ruling by the Court of Appeal represents the best evidence engagement teams have of the legal position. The industry has called on the Department of Work and Pensions (DWP) and the secretary of state to use their power under current legislation to make regulations to validate, retrospectively, past rule amendments that were void solely because of a lack of s37 confirmation. However, there's no guarantee that the DWP will do this, and even if they do, there's a question of how long this would take given the change in government and other priorities.

British Broadcasting Corporation (BBC) v (1) BBC Pension Trust Limited and (2) Christina Burns

Another high-profile case has attracted attention in the last year.

In May 2022 the BBC announced a review of its future pension provision for employees. At that time the BBC also confirmed that it had decided to ask the High Court to rule on the correct interpretation of one of the Scheme's Rules. The BBC asked the Court whether it might be possible to change future service benefits and/or member contributions for active members under the power of amendment in the Scheme's Trust Deed and Rules (Rule 19) and, if so, on what terms and by what process.

The High Court hearing took place in May 2023 and its decision was issued in July 2023, concluding that Rule 19 can only be used to change future service benefits and/or member contributions for active members where both the trustee and the BBC agree the change, and one of three conditions set out in Rule 19 has been satisfied, that:

- the scheme actuary has confirmed that active members won't be substantially worse off as a result of the proposed changes
- if active members will be substantially worse off, the scheme actuary has confirmed that active members will be provided with suitable alternative benefits (which must be substantially equivalent to the benefits being replaced)
- the active members as a group have agreed to the proposed changes at a duly convened meeting of active members.

The BBC was granted permission to appeal the High Court's decision to the Court of Appeal. This was heard and dismissed in June 2024. The Court of Appeal upheld the decision of the High Court that the BBC can't use Rule 19 to make changes to future service benefits and/or member contributions for active members without going through one of the routes set out above.

It isn't presently clear whether the judgment will have a wider impact, and this may depend on whether other pension schemes contain similar restrictions to those found in Rule 19 (power of amendment) of the BBC Pension Scheme. The key points are:

- this only applies to defined benefit schemes or defined benefit sections of hybrid schemes
- the key issue is the specific wording used in the deed or rules for each respective pension scheme setting out how and when trustees can use their amendment powers, and if it includes similar wording to the BBC case, where there's a restriction on using the powers when the impact will make members worse off
- if such restrictions are found, the trustees need to review whether amendments made under these amendment powers to reduce, amend or cease member benefits may be invalid. This may have a material impact on defined benefit obligations for employers or benefits payable to date for pension schemes.

Other sector developments, VAT, and tax

Budget Balancing Act

What charities need to know about rises to National Minimum Wage and Employers National Insurance

The recent increase in employers National Insurance Contributions (NICs) is likely to have a significant impact on the charity sector, particularly as many charities operate with limited budgets and the ability to increase funding levels is limited. For charities, which often have tight financial constraints, any increase in operational costs will be challenging.

The increase in employers NICs will raise the cost of employing staff, which could reduce the charity's capacity to hire or retain staff, limit salary increases or even affect delivery of services. Many may need to scale back the activities that define their purpose as a charity, in order to divert resources to meet their obligations as an employer.

This issue has seen many groups lobbying the Government for an exemption for the charity sector, with The National Council for Voluntary Organisations (NCVO) writing to the Chancellor with a letter co-signed by over 7,300 charities and the matter being debated in parliament. The Government, however, shows no signs of backing down.

How can charities respond to these changes?

Beyond efforts to increase fundraising levels and cutting operational costs though things like pooling resources with similar organisations, charities should look at their employment costs more generally, to see how these increases can be mitigated.

It's important for employers to ensure that they're doing everything they can to keep costs down, whether in relation to benefits or expenses, and maximise the value of their spend where possible. Despite increased costs, offering a competitive reward and benefits package is still essential for attracting and retaining talent.

Understanding the cost of providing employee benefits, and opportunities available, can help an employer to mitigate some of the additional costs. With the effective use of salary sacrifice, it's possible to expand the range of benefits while saving money at the same time.

Budget 2024: three key measures for employers

Rachel Reeves' October 2024 Budget since introduced several changes that will increase the cost of employing people:

1

Increase to Employers National Insurance Contributions

The rate of Employers NICs will rise from 13.8% to 15% as of 6 April 2025. The secondary threshold, the point at which contributions are due, will also decrease from £9,100 to £5,000. These two measures will lead to significant additional costs for all but the smallest employers.

2

Increase to National Minimum Wage rates

The minimum wage for over-21s is set to rise by 6.7% from £11.44 to £12.21 as of 1 April 2025. For someone working a 37.5-hour week, that equates to more than an extra £1,500 per year. Employees under the age of 21 and apprentices will also see increases, and employees further up the pay scale may also expect similar increases, to protect the relative value of their salary.

3

Frozen tax thresholds

The freeze on income tax thresholds will still continue until 2028. This means that any future pay rises over the next few years will face a higher burden of tax (in real terms), increasing the pressure on employers to provide above-inflation rises. With inflation still a concern, employees are increasingly interested in benefits that can help them manage financial pressures, such as cost-effective health care, transport subsidies, and increased salary sacrifice options.

Realising the potential of salary sacrifice

Pension salary sacrifice, cycle-to-work schemes, and electric-vehicle leasing can all form key components of an employee benefit package, alongside core benefits such as group risk and healthcare. Each of these benefits offer employers' NICS savings, with more available as uptake increases.

Additionally, holiday trading offers employees the opportunity to sacrifice salary in exchange for more annual leave. This can lead to decreased salary and national insurance costs for an employer and may be a more attractive option than redundancies or recruitment freezes.

Employees can also save on both NICs and income tax, depending upon the benefit. Care is needed when designing and implementing these schemes to ensure tax and NMW compliance. Online benefit platforms can also play a key role in creating effective member pathways to help employees engage with what's on offer, and model the potential monthly costs of any selections.

Renegotiating existing benefits

It's often possible to secure more favourable terms with existing benefit providers. The market is very competitive with insurers that are keen to retain business.

It's usually possible to get more leverage from existing benefits too, by making the most of value-added services, such as employee assistance programmes. This can help identify and remove duplication from any benefit spend.

Platform charges have also seen increased costs in recent years. Benchmarking any existing costs can also lead to savings. Similarly, consultancy costs, whether in fees or commission, should be assessed to ensure value for money. Commission can often be hidden within a premium and it may be cheaper to switch to a fee-basis and pay a lower premium.

Restructuring existing benefits

In some circumstances, in the face of rising costs an employer may regrettably conclude that certain benefits are simply unaffordable. This could be especially true for charities that may have seen large annual premium increases due to a poor claims history.

It's usually possible to restructure a benefit to make it more affordable and this should always be considered before removing a valued benefit entirely. For example, you could consider the scope of health conditions a medical scheme covers. Alternatively, a limited payment term for group income protection claims could be introduced.

Think about tax-free benefits

Employee expenses can be a considerable cost to a business. When the tax and NIC costs are taken into account, particularly given the rise in PSA costs, which are further amplified by the freeze in thresholds, the impact is likely to continue to increase.

Having robust processes and controls in place, through up-to-date expense policies and systems, can help to manage this. Taking advantage of employment tax exemptions may provide further opportunity to maximise spend, along with awareness of tax-free benefits. The ability to offer benefits such as work-related training, holiday purchase, or trivial benefits, can enhance your employee value proposition, often with little or no additional cost.

The value of voluntary benefits

Whether through inflation and the cost of living, shifting work/life habits, or increased flexibility, employee expectations have clearly changed. Offering remote and hybrid working options, enhanced mental health support, or financial wellbeing services might be more important now than in previous years. Employee reward packages are evolving, as people expect a much broader range of diverse benefits that support different aspects of their lives.

Employee-funded voluntary benefits are therefore a great option, as employees can still benefit from being able to participate in a collective scheme with far better terms than they could receive as an individual.

The post-Budget benefits package

The Budget has prompted many charities to consider how they can deal with increased employment costs, but it's important to remember that there's often scope to make employment cost savings that will help to offset some of these. Transparency and clear communication are essential when making any changes to benefits packages. Employees should understand how any changes will impact them, including from a tax perspective, and what new or revised benefits are available, otherwise there's a risk that take-up rates are lower than hoped for, along with any associated NICs savings.

A thoughtfully crafted benefits package offers mutual value: employees experience greater peace of mind and appreciation, which translates into reduced stress, increased loyalty, and heightened productivity. In turn, employers enjoy reduced absences, lower turnover, and a stronger ability to attract top talent.

The impact of redundancies in charities and managing some of the key people risks

In 2024, numerous charities were compelled to implement organisational changes, leading to reductions in headcount and redundancies. These decisions were made to ensure the continued delivery of essential services by the charities. This has been driven by a combination of financial pressures, changes in funding, and the need to adapt to new ways of working.

Redundancy programmes are underpinned by the Employment Rights Act 1996 which includes a number of processes which need to be followed to ensure the charity's activities are aligned with employment legislation. While following the processes laid out by employment law is of utmost importance, there are also other factors to consider when going through organisational change and the impact this has on employees, customers, clients, investors, and the public. Poorly executed changes can affect a charity's reputation, finances, ability to retain key staff, and potential to secure additional funding through new channels.

This section is aimed at sharing some of the areas of people risk that should be considered and managed when going through such an organisational change. The change affects not only those directly impacted, but also others indirectly impacted. These include employees who interact with functions going through change; employees who are successfully redeployed and have survived the change; or the clients who use services and interact with team members who are going through the change. Navigating these complex areas is key to ensuring that relevant legal requirements are met, and staff engagement and customer satisfaction levels are managed and maintained.

Understanding the decision making process and the impact of these redundancies will also help stakeholders appreciate the challenges which charities face and the strategies available to navigate these change activities effectively.

Redundancies – some crucial decision making processes

- **The assessment process:** Charities often begin by conducting a financial assessment to determine the sustainability of their operations. This includes reviewing income streams, expenses and reserves. When funding decreases or costs increase, charities may need to alter their activities or modify their methods of operation. Although the financial aspect is a significant factor, for redundancies to be legitimate, whether they're mandatory or non-compulsory, the charity must prove that the position(s) in question meets the required redundancy criteria.
- **Exploring alternatives:** Before making any redundancy decisions, charities typically explore a number of alternatives. This can include measures such as reducing working hours/overtime, short time working, stopping recruitment activity, reducing the use of temporary employees, or reorganising operations where possible. These steps are taken to minimise the need for redundancies.

Some key process areas to consider

- **Consultation and communication:** A critical part of the redundancy process is the consultation process with employees and the trade unions (where applicable) and communicating key messages and changes transparently. Charities must follow legal requirements for consultation, ensuring that employees are informed and the impact on them personally is understood. The time period to consult is driven by the number of employees impacted by the change. Effective consultation is where individuals are given the opportunity to provide input in individual consultation which helps to foster a sense of fairness and inclusion, even in difficult times. Effective consultation and transparent communication are key aspects of demonstrating strong leadership during the redundancy process.
- **Key process requirements – selection criteria and notice:** When redundancies are unavoidable, charities must establish fair and transparent selection processes and criteria. This ensures that decisions are based on clear, justifiable reasons and helps to avoid claims of unfair dismissal, direct or indirect discrimination, or unfair selection for redundancy.

Following the redundancy consultations, the next steps will involve issuing notices and notice/ redundancy pay to the affected employees.

Impact on services – what to consider?

- **Service delivery:** Reducing staff can have a direct impact on the delivery of services. Charities may need to prioritise certain activities or reduce the scope of their activities to align with their reduced workforce. This can lead to longer wait times for services, the discontinuation of less critical activities or the need to repurpose ways to deliver services.
- **Staff morale and wellbeing:** The redundancy process can impact a number of employee groups and individuals, and not only those directly impacted and going through the process. This can also apply to individuals who have secured alternative positions within the organisation or those in functions not directly affected but who need to engage with new roles and potentially new systems or methods of operation. Being aware of, and addressing key areas, including communications and line management support, and highlighting tools such as the employee assistance programmes to support employees' wellbeing and engagement is important. Charities must provide support to their employees, including counselling services and opportunities for professional skills development or coaching support to help them navigate through the changes.
- **Reputation and trust:** How a charity handles redundancies can impact its reputation and the trust of its stakeholders. Transparent communication and fair treatment of employees are crucial in maintaining the confidence of donors, beneficiaries, and the wider community.
- **Innovation and adaptation:** Despite the challenges, redundancies can also drive innovation and adaptation. Charities may find new ways to deliver services more efficiently or develop partnerships that enhance their impact. This period of change could ultimately lead to a more resilient and agile organisation.

Key areas for consideration

- **Compliance with employment laws:** Charities must follow the legal requirements for redundancy, including fair selection criteria, consultation periods with employees and consultative bodies, and providing adequate notice and severance pay. Failure to comply can result in claims of unfair dismissal or discrimination leading to financial and reputational risk.
- **Loss of institutional knowledge:** Redundancies can result in the loss of valuable institutional knowledge and expertise. Coupled with this are risks such as key person dependencies. Charities should consider the processes and controls in place for managing these areas and whether activities can be easily split among individuals or outsourced.
- **Transparent communication and support:** Effective communication is crucial to maintaining trust and morale among all employees, including those not directly impacted by redundancies who are regularly forgotten during the exhaustive consultation processes.
- **Providing support:** Such as counselling services and career development opportunities helps maintain engagement and reduce anxiety among the remaining staff.
- **Stakeholder communication:** Keeping clients and customers informed about changes and how they will be affected is important for maintaining trust and support. Effective stakeholder communication is crucial, as social media and other publications can often disseminate misleading or negative messages that may impact the charity's reputation and stakeholder trust.
- **Succession planning:** Identifying and preparing future leaders within the organisation can help mitigate the impact of losing key staff members. Charities should also consider the use of knowledge management strategies to capture and retain critical information.

In conclusion, while redundancies in charities are often a last resort, they're sometimes necessary to ensure the long-term sustainability of the organisation. By understanding the decision making process and the impact on services, stakeholders can better appreciate the complexities involved and support charities through such challenging times.

VAT updates

Many fee-paying private schools are also registered charities. The recent changes to the taxation of private schools are having a significant impact on this part of the sector.

HMRC introduced new VAT legislation which requires fee-paying private schools to add 20% VAT to their school fees. The Government has complicated the position by requiring private schools to continue to apply VAT exemption to goods and services that are closely related to education, eg, school meals, transport, books, and stationery. These will remain exempt after January 2025 as they're seen as necessary for education rather than an additional stream of revenue.

The legislative change has come mid-way through the academic school year and so there will be a split in treatment so that fees related to the 24/25 winter term will be exempt from VAT, with any fees following this period being taxable. It has required detailed analysis by the schools to consider what additional VAT, if any, needs to be passed on to the student immediately and/or if the additional costs can be passed on over a period of time.

As the January 2025 registration date has now passed, there are a number of key issues which the schools must have addressed to reduce their potential risk and exposure:

VAT registration

With this recent change in legislation, private schools had to register for VAT from 1 January 2025. The addition of VAT on school fees provides for the VAT recovery of related costs, however, due to the continuation of VAT exemption for closely provided services (and other potential exempt income such as rent and pre-school nursery fees) the schools will be required to understand the complex 'partial exemption' VAT recovery rules.

The first VAT return submission will need careful consideration, including:

- is the accounting system set up to be able to record and manage VAT?
- is the financial team adequately trained to be able to consider VAT and the complexity around liabilities and the attribution of costs to arrive at the partial exemption VAT recovery position?
- is there any VAT incurred on goods and services before VAT registration recoverable and what calculations and records would HMRC need to verify to agree any related VAT recovery?
- do the schools have the necessary 'making tax digital' software to submit the VAT return electronically to HMRC?

If the school hasn't already registered, we would recommend taking further advice on the best way to backdate the registration and ensure VAT has been accounted for correctly.

We've highlighted some further complex considerations below.

Potential other areas for concern

As this is a new VAT accounting treatment, we would expect that schools will need to seek additional advice surrounding the following areas:

- As touched on above, partial exemption calculations will require the finance team to be equipped with the knowledge to correctly attribute VAT on costs to its activities
- The software for VAT accounting will need to be reconfigured
- The treatment of school fees pre-payments received in July 2024 and earlier before the new VAT rules were announced will need to be reviewed. There's specific anti-forestalling legislation that seeks to ensure that schools charge the correct amount of VAT on fees and services provided for the period 1 January 2025 and onwards

- Capital spend on school sites is captured by the VAT Capital Goods Scheme (CGS) – the scheme will enable the school to potentially recover VAT incurred on capital spend incurred in the last ten years. However, this calculation is complicated, and specific advice will be required to identify how many buildings qualify as a CGS item and also at what year the adjustment to a taxable use occurred. The scheme will potentially bring a VAT windfall and VAT recovery position that the school could offset against raising the school fees, and so getting the position correct at the outset would be advantageous
- For spend on other non-capital goods and services purchased prior to registration, a proportion of this may be able to be recovered through the first VAT return, depending on how long ago the cost was incurred and whether the assets are still owned
- School bursaries and the accounting treatment for them will need to be carefully considered, ie, the school will account for VAT on the total amount of the fee charged for the education, even if this is made up by both the parent's payment and a separate bursary paid for that child

We envisage litigation in a number of areas and our specialist VAT team are in detailed discussions with our clients to ensure this new VAT landscape is fair and equitable.

VAT case law update

We have three recent VAT decisions that impact the charitable sector. We summarise the key take aways from each decision below.

Yorkshire Agricultural Society – 2025 UKUT 4 (TCC)

Yorkshire Agricultural Society is a charity that puts on an annual county show (the Great Yorkshire Show) as part of its aims. It claimed its ticket sales from the 2016 Great Yorkshire Show should qualify for the charity fundraising exemption (VAT Act 1994 Sch 9 Group 12). The dispute originated on the VAT liability of income generated specifically from the 2016 Great Yorkshire Show and was resolved in January 2025, following an Upper Tier Tribunal (UTT) decision.

Charities may be aware that for the fundraising to be VAT exempt it must meet the following criteria:

The supply of goods and services by a charity in connection with an event –

- **A** That is organised for charitable purposes by a charity or jointly by more than one charity
- **B** Whose primary purpose is the raising of money
- **C** That is promoted as being primarily for the raising of money

The First Tier Tribunal (FTT) considered that the Society met these conditions and allowed the appeal.

HMRC appealed to the Upper Tier (UT) on the basis of the definition of 'primary purpose' as it considered that the society was running the shows for other reasons than just raising money, including promotion of farming in general.

The UT considered that the FTT was correct in its judgement as if there were two equal purposes, this didn't mean that there was no primary purpose. When considering the EU law from which it was derived, the use of the word 'primarily' in criterion 1c was unnecessary. The time window for HMRC to appeal again and take this further has now passed.

This decision could potentially widen the range of circumstances in which an activity could fall within the exemption for fundraising events.

This is a complicated area of VAT and we recommend that advice is sought to determine VAT exemption for fundraising events.

Wolverhampton Citizens Advice Bureau v HMRC - MAN/96/1145

Wolverhampton Citizens Advice Bureau (WCAB) attempted to recover VAT on legal and similar services that they provided to local citizens. WCAB had received funding from the local authority who required it to enter into a service-level agreement which set out the opening times and level of service to be provided.

On this basis WCAB viewed the funding to be a consideration for a taxable supply of services to the local authority. HMRC disagreed with their view and the case was taken to the VAT tribunal. It was found that there was insufficient evidence in the service level agreement to support WCAB's view. Therefore, the money received from the council was a grant and as the only supplies were made to the local citizens and were mainly free of charge, there's no supply for VAT purposes, therefore WCAB wasn't able to recover any VAT.

Where there's a grant and then a supply of services, there's a list of indicating factors that must be taken into account and as the values can often be significant, so we would recommend charities seek further advice to ensure the correct VAT treatment is applied.

Midlands Partnership University NHS Foundation Trust v HMRC

This case revolves around whether the trust's provision of healthcare services should be exempt from VAT under UK legislation.

The Midlands Partnership University NHS Foundation Trust (the trust) was commissioned by local authorities to provide certain free-at-the-point-of-use, health services to the public.

The trust believed that the services provided were 'non-business' supplies and therefore outside the scope of VAT. They argued that their services were similar to the services provided by doctors and dentists in private practice and therefore should be VAT exempt.

Even if the supplies weren't seen as 'non-business' the trust also argued that they're not a taxable person because they were made by the trust as a public body pursuant to a special legal regime.

Under s.41 of the VAT Act 1994, public bodies are able to claim VAT incurred in relation to non-business activities and should therefore claim VAT under the normal VAT recovery rules.

HMRC considered that these services were supplies by way of business, and that the provision of sexual health and health visiting services were exempt supplies, and that infection prevention and control services were standard-rated supplies. Therefore, the trust wouldn't be able to claim a refund of VAT under s.41.

The trust then sought judicial review from the Upper Tribunal (UT). The UT rejected the trust's grounds for judicial review. They decided that the trust's services were supplied for consideration, namely the payments made by the local authorities for the services provided and therefore a business supply. The UT also considered that the trust's activities were an economic activity. As a result, the trust wasn't able to claim a VAT refund under s.41.

The UT considered that the trust was a taxable person, on the basis that it was acting as a public authority under a special legal regime and concluded that the trust wasn't acting as a public authority in this context. The trust's judicial review application was dismissed.

Although the trust isn't a charity, this decision could affect any charities that receives grant funding from local authorities in return for carrying out defined activities as it could change how they're seen for VAT purposes (ie, being an exempt or taxable body).

The business non-business rules introduced in 2022

When deciding the VAT treatment of the supplies made, charities must first consider whether the supply has been made for the purpose of business – for charities, this means for the purpose of meeting the charitable objectives. VAT is only chargeable where there's a supply of goods or services in the course or furtherance of business.

Businesses can no longer rely on the old 'business test' and the six criteria which were previously used to decide whether an activity is business or not, but it can be used as a set of tools designed to help identify those factors which should be considered. Charities may be aware that HMRC confirmed the two stage test in Revenue & Customs Brief 10/2022.

Two-stage test

By way of a refresher the following is the two-stage test for determining whether a supply is one for business purposes for VAT:

1

Does the activity result in a supply of goods or services for consideration?

This requires the existence of a legal relationship between the supplier and the recipient. The first step is to consider whether the supply is made for a consideration. An activity that doesn't involve the making of supplies for consideration cannot be business activity for VAT purposes.

'Consideration' doesn't have a definition in UK law. However, the UK courts have defined it, simply, as the price at which the goods or services were supplied.

This can be furthered evidenced by the use of certain terms which are hallmarks for the existence of a service agreement.

2

Is the supply made for the purposes of obtaining income?

Where there's a direct or sufficient 'link' between the supplies made and the payments given, the activity is regarded as economic. Simply because a payment is received for a service provided doesn't itself mean that the activity is economic. For an activity to be regarded as economic it must be carried out for the purpose of obtaining income (remuneration) even if the charge is below cost.

If both of the conditions of the business test are met, then there's a supply of goods or services in the course of furtherance of business. We're experiencing queries in this area, especially, as there's a shift towards the provision of contracts rather than the provision of grants.

Contracts v grants

Over recent years there's been a shift in Government funding from grants to the awarding of contracts. As a result of this shift, there may be some VAT implications.

Generally speaking, grant funding is outside the scope of VAT as a grant doesn't equate to the provision of a service.

Contracts however, whether for the delivery of goods or services, will usually attract VAT. Depending on the nature of the goods or services being supplied the services may be exempt, zero-rated or standard rated.

Many charities suffer VAT as an actual cost because usually the services they supply are only exempt and as such they can't recover the input tax they have paid on goods and services they have bought.

In entering into any sort of funding agreement, charities need to think carefully about what the true relationship is. Consideration should be given to the following factors to determine what the correct treatment would be.

We've seen many charities have difficulty with this and are therefore unsure on how the structure of their funding relationships affects their VAT liability and, unfortunately, it's often difficult to determine whether the contract will fall under a grant or not. Therefore, we recommend that charities seek further advice to ensure the correct VAT treatment is applied.

E-invoicing

E-invoicing is an initiative that's already being implemented across Europe and it's likely that the UK will follow this. HMRC has launched a consultation on e-invoicing with the purpose of increasing its use across the whole of the UK. The timeframes and scope aren't yet known but we'll release relevant updates when possible.

Additional VAT areas for concern for the not for profit sector

In our experience, not for profit organisations should take further advice in the following areas as they can be complicated and difficult to ensure the correct VAT treatment is applied:

- In cases where there's a non-registered or largely exempt entities who are part of a VAT group. The group then doesn't make management charges to that entity for services provided by the head office
- Partial exemption and the related calculations
- Land and property transactions

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