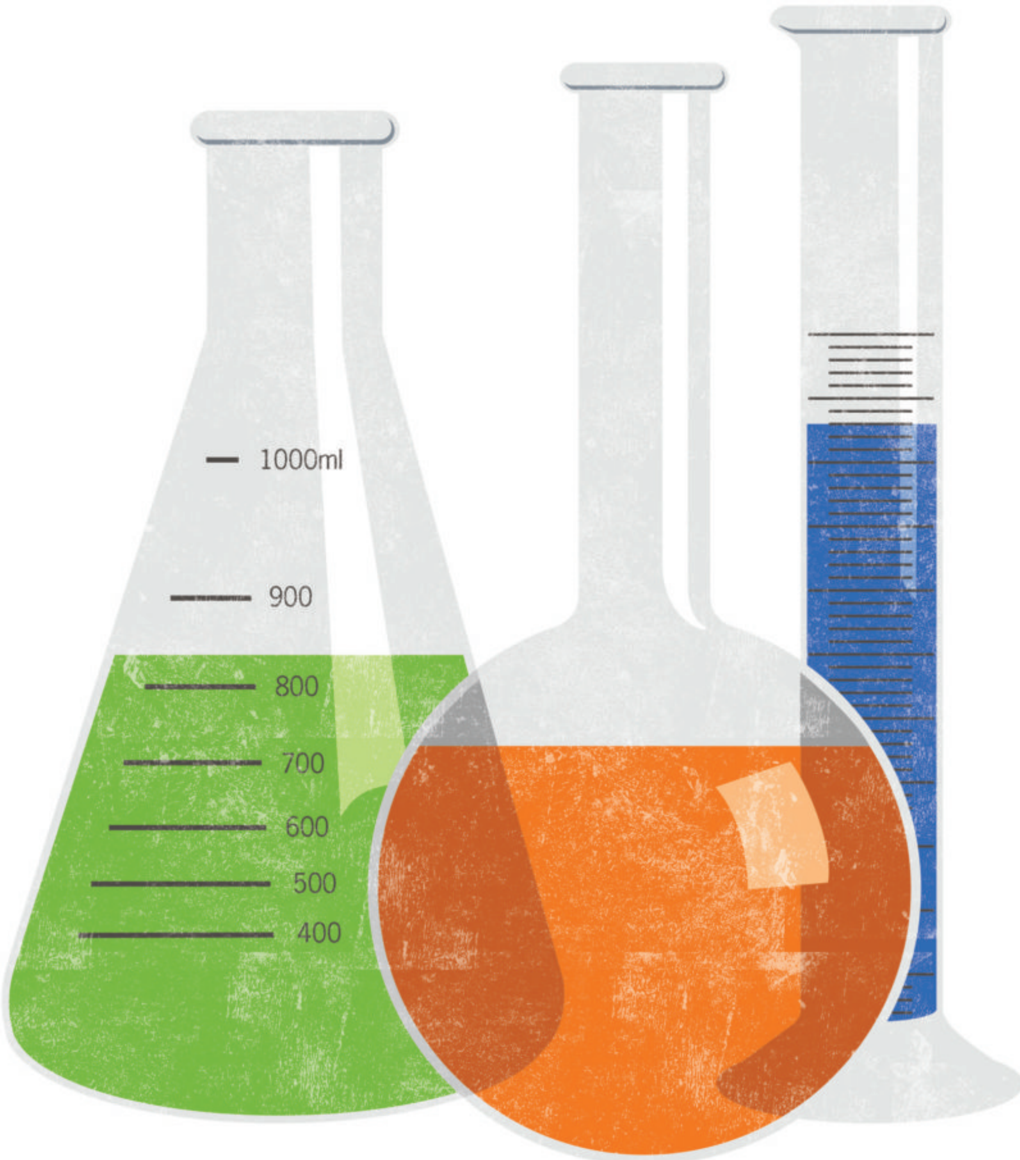
CHARITY GOVERNANCE REVIEW 2013

The science of good governance
Towards charity best practice



2013 highlights of the top 100 charities

Contents

Methodology

This report is based on a desktop review of the latest financial statements of the top 100 charities (by income) filed by Summer 2012. The range of financial year-ends means the financial statements reviewed span from 31 December 2010 to 31 March 2012.

We have based our review on the Charity SORP (Accounting and Reporting by Charities: Statement of Recommended Practice), the Charities Act 2011, the Companies Act 2006 and best practice guidance from other sectors, such as the UK Corporate Governance Code.

Carol Rudge would like to thank Amanda Tilley, Louise Truswell, Ian Falconer, Jenny Brown, Simon Lowe, Andrew Antwi, Sarah Beeson, Tosin Fambegbe, Brandon Li, Charity Tedder and Mark Woollard for their help in preparing this report.

Foreword

Welcome to Grant Thornton's first annual review of the governance practices of the top 100 charities.

Carol Rudge, Head of Not for Profit – UK and Global

The charity sector is facing unsettled times. Public sector funding is being cut and voluntary donations are under pressure. Such reductions in income, coupled with an increasing demand for services, mean that many charities are feeling the squeeze. In these tough times strong governance is more important than ever to enable charities to respond effectively and quickly to emerging risks and deliver their objectives.

"Our research highlighted many examples of good governance practice: the 31% representation of women on charity boards, for example, is an achievement most corporates would envy."

In this challenging context, our review aims to support charities in using their annual reports to manage, and communicate, their governance more effectively and in doing so build greater trust. Governance extends far beyond board composition and the frequency of committee meetings; an organisation's culture, people and public face and how it sets the right tone are all an integral part of governance. Good governance should be transparent and open, encouraging trust within, and of, an organisation. The charity sector, working for the public benefit, should be in a position to demonstrate good governance with the top 100 setting the tone and showing best practice for others to follow.

Our review is based on an analysis of the annual reports of the top 100 charities, through which we assessed structure, governance, risk management and impact. We also considered the disclosures included within the annual reports, although clearly disclosure does not necessarily reflect everything charities do in practice.

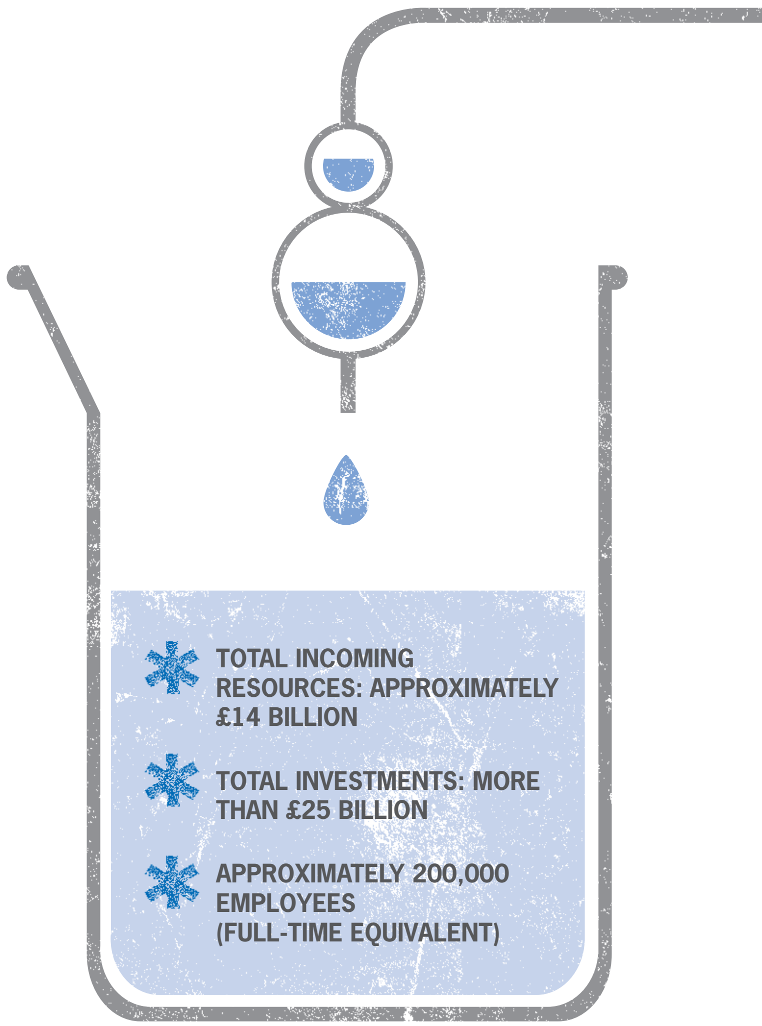
Our research highlighted many examples of good governance practice: the 31% representation of women on charity boards, for example, is an achievement most corporates would envy. However, naturally there are areas where charities could develop further to achieve best practice. Grant Thornton has reviewed the governance of the FTSE 350 companies for the last 11 years and now also publishes governance reviews of local government and the NHS. Where relevant, we therefore draw out examples from all of these sectors.

Overall, greater benefit could be obtained from annual reports. These publications represent a real opportunity for organisations to demonstrate transparency and trust showing how they are governed, what they have achieved and their culture. And, for good or ill, they have a wide potential audience, with all charity financial statements being available free from the Charity Commission website. We found that a number of charities stop at meeting the minimum reporting requirements, rather than providing a comprehensive picture of their organisation and its achievements and future plans. Such minimalistic annual reports comply with the law but, we believe, are a wasted opportunity.

The values-driven objectives of most charities mean they have a robust ethical foundation. However, many charities don't yet use their reporting to emphasise their commitment to good governance. In FTSE 350 annual reports, 75% of chairmen now provide some insight into their board's governance practices, with a growing number, 23% (2011: 10%), using their Chairman's principal statement to emphasise the importance of good governance. Such explicit support for effective governance would be valuable within the charity sector.

The top 100 charities have characteristics akin to leading UK corporates. They are large, high profile organisations that need to be transparent and meet best practice. The Charity Commission provides a framework for governance in The Hallmarks of an Effective Charity and in its support for the voluntary code, Good Governance – A Code for the Voluntary and Community Sector. Presently, the same guidance is used by all types of charities, from complex multinationals to local groups but we believe that one size should not fit all. Guidance must evolve to meet our leading charities' own evolution.

Contribution of the top 100 charities to the UK economy



The regulator's perspective

Sam Younger, Chief Executive, Charity Commission

Good governance and accountability

This review provides a valuable insight into the governance arrangements of some of the largest charities on the Commission's register. Good governance matters to us as regulator, because it promotes compliance with the law and has a strong bearing on a charity's effectiveness in achieving its mission. Good governance in charities is therefore not an added bonus; it's at the heart of what makes charities successful. And conversely, the Commission's casework demonstrates that basic failures in governance are often at the root of very serious problems in charities. By focusing on the information these charities make available through their trustees' annual reports (TAR) and accounts, this study also underlines the important connection between good governance and accountability. In terms of upholding the precious reputation of the charitable sector, *being seen* to adhere to good governance principles is no less important than the good governance itself. Not only do many charities resource their work directly through voluntary donations and volunteers' time, the entire sector benefits from indirect public support through the legal and fiscal privileges charity status confers. So what charities tell us in their annual reporting matters – and what the largest, most visible charities say matters all the more. This report rightly emphasises the role these charities play in setting an example for less well resourced charities.

Legal minimum vs best practice

It is clear that most of the TARs analysed in this review meet the basic requirements as set out in the Charities' SORP and our guidance Charity Reporting and Accounting: The essentials (CC15b). This is encouraging. But these requirements are minimum standards, not best practice. Whilst it is important for the Commission as regulator to make a clear distinction between our role in setting out the law, and the sector's own responsibility for agreeing best practice, we would certainly agree with many of the recommendations set out in this report. A good example of an area that falls into the realm of best practice is impact reporting. It is not for the Commission to dictate how much creativity charities should employ in explaining what their work achieves. But we strongly encourage initiatives within the sector itself to develop charities' performance in this area.

Trusteeship

This report rightly emphasises the role and responsibilities of charity trustees. Trustees are the guardians of their charity's mission, and the law gives them not only important responsibilities, but also considerable discretion. It is therefore vital that trustees understand their role, feel comfortable making decisions and have confidence in their judgement; the Commission's guidance aims at achieving just that. We would therefore second the recommendation set out in the review that charities include details in their annual report as to how trustees are recruited, inducted and trained. We also strongly agree that successful charity boards require a diverse range of skills and experience. It is heartening to note that charities appear to do slightly better than large companies in terms of gender balance – but there is clear room for improvement. The average age of trustees, for example, is 57, and young people between the ages of 18 and 24 are woefully underrepresented on charity boards, despite the fresh perspective and skills they can bring to charities.

Risk management

Among trustees' key responsibilities is assessing the risks associated with any decision they make on behalf of their charity, or with the wider circumstances their charity is subject to. The Commission's guidance encourages trustees to be aware and informed about risk, and not unnecessarily risk averse. Sometimes taking measured risks is the only way of achieving innovation and improvement. It is clear that, compared to commercial companies, risk reporting is less well developed among charities and the Commission agrees with the authors of this report that charities should provide more detail as to the nature of the risks they face and the steps trustees are taking to address these risks.

Governance and structure

The role of trustees

Our leading charities have developed the footprint and influence of multinational businesses yet from the information disclosed it appears that their governance frameworks may not have kept pace.

The board of trustees, the traditional format for a charity board, is a charity's governing body. It has the key responsibility for overseeing an organisation's strategy and governance and safeguarding its assets.

In the case of incorporated charities, trustees are also the directors of the company. Trustees are somewhat akin to the non-executive directors of commercial companies as, in the larger charities, they have no management responsibilities. Their role is to give strategic direction.

Many people join charity boards to give something back to their community or to support a cause they believe in. This is often a time-consuming, unpaid commitment to discharge their duties effectively.

"Trustees are somewhat akin to the non-executive directors of commercial companies as, in the larger charities, they have no management responsibilities."

Understanding the organisation

To be effective, trustees must have a real understanding of what the charity does, its structure, its aims and how it means to meet those aims. Trustees may need support in building this understanding. In requiring organisations to report how trustees are inducted, and on their ongoing training, the Charity SORP indicates that training is an essential step in enabling trustees to discharge their duties.

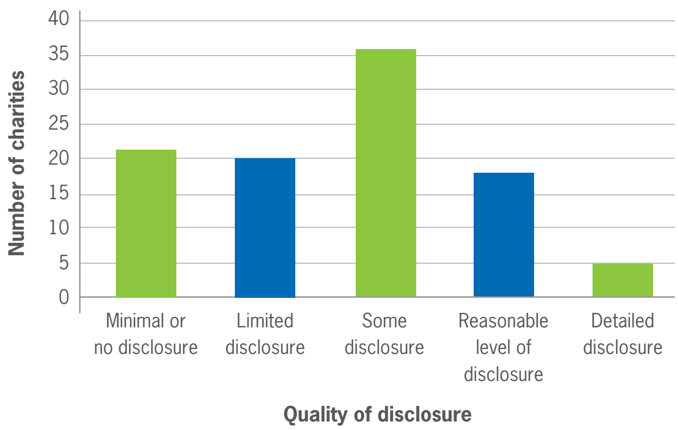
"In particular the report should explain … the policies and procedures adopted for the induction and training of trustees."

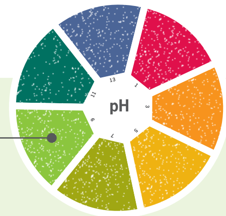
Paragraph 44c, Charity SORP

Our review of the top 100 charities' annual reports showed 20% made little or no mention of any induction for new trustees, nor commented on on-going training for existing trustees. This does not mean that training is not being undertaken but, if it is, good governance requires it should be disclosed. With legislation and guidance changing regularly it is important that trustees keep up-to-date. In disclosing their good practice, the top 100 charities could help show smaller charities what good governance looks like.

"20% made little or no mention of any induction for new trustees."

TRUSTEES' INDUCTION DISCLOSURE





TRUSTEE INDUCTION

What does good disclosure look like?

Induction should provide a robust understanding of charity strategy. This would normally include:

- meetings with the board and key management
- attending a trustees' meeting before becoming a trustee
- visits to key locations or service providers
- ongoing training in legislation and responsibilities.

There still seems to be a lingering public perception that seats on charity boards are easy to get, possibly because most positions are unpaid. The review of the top 100 charities showed little disclosure of the selection and appraisal processes for trustees. If larger charities summarised their selection procedures and requirements they might build greater awareness of the attributes and responsibilities required of, and demonstrated by, trustees.

The recruitment and development of trustees is as serious a matter as the training of paid staff that deal with beneficiaries. Some boards may be reluctant to appraise the performance of trustees, or insist on attendance at meetings, as trustees give their time voluntarily. However, poor performance from trustees is as great a risk to a charity as the dereliction of duty from employees.

Representation on the board

Effective boards need a variety of personalities, with a range of skills and experience, that can work well together. The skills required depend on the type of organisation: some charities have quotas for the proportion or number of representatives from stakeholder groups, such as local government or beneficiaries.

Our review showed that very few charities (6%) use their annual reports to disclose the skills of their trustees. This makes it difficult for readers to understand what particular skills or experience trustees bring to the board and conversely where gaps exist.

We would encourage charities to give brief biographies of the trustees so users can understand the range of skills and experience of the trustees.

EXAMPLE BIOGRAPHY FOR THE CHAIR OF TRUSTEES

Ann Anderson, Chair of Trustees

Ann joined the charity as honorary treasurer in 2006 and was elected chair in 2010. A chartered accountant, she has spent her career in a variety of finance and strategy roles including with Y Ltd and Z Ltd. Ann is currently CFO of X plc. She has personal knowledge of our services from volunteering as a foster carer from 2000 to 2004: she is also a mother of four. Ann is a trustee of X charity, a role she has fulfilled since 2009. Ann's period as chair will cease in July 2014 at the end of her four-year rotation period.

Diversity of the board

"The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively."

UK Corporate Governance Code, main principle B.1

"The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender."

UK Corporate Governance Code, supporting principle B.2

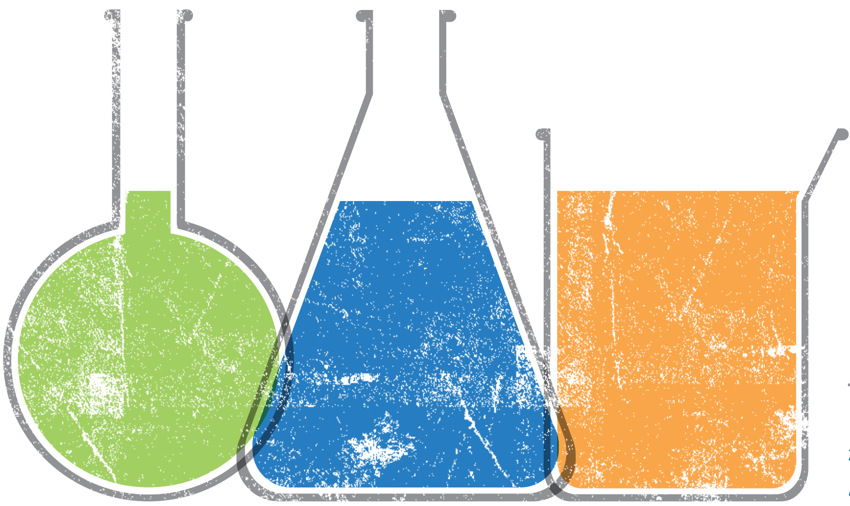
Charity boards are significantly more likely to have women on their boards than FTSE 350 companies. Our review of the FTSE 350[1] shows that, while female representation in the boardroom has increased, it is still just 10.8% (2011: 9.8%). There is a much higher representation among FTSE 100 non-executive directors, where 21% of positions (2011: 18.2%) are held by women. On charity boards, 31% of positions are held by women.

The 2011 Davies report 'Women on Boards', which recommended that 25% of board members be female by 2015, has encouraged FTSE 100 companies to disclose their policies on gender diversity in their annual reports (currently 78% do). However we found very limited discussion of gender or indeed their wider diversity aspirations in the top 100 charities' annual reports.

75 of the chairs of top 100 charities' boards are male and 14 female. For the remainder the gender of the chair is not made clear in the report. This still compares favourably with the FTSE 350 where only three women are chair.

Gender is clearly not the only relevant type of diversity that could benefit charity boards. The charity reports reviewed gave little background on board members. In some instances, only initials and surnames are provided. Once again, this does not help the reader to build up a picture of the board.

At present, the ages of trustees are not disclosed: although a September 2010 Charity Commission survey[2] showed the average age of trustees was 57, with two-thirds over 50. This is similar to that of non-executive directors of FTSE 350 companies, who have an average age of 59.



"Charity boards are significantly more likely to have women on their boards than FTSE 350 companies."

[1]The Chemistry of Governance: A Catalyst for Change, Grant Thornton, January 2013
[2] A Breath of Fresh Air: Young people as Charity Trustees, Charity Commission. September 2010

FAST FACTS ON THE TOP 100 CHARITIES' TRUSTEES

31% of trustees are women

Where it is possible to tell, boards have an average of four female trustees

More than 75% of reports give minimal disclosure of the trustees' background or experience

The use of committees

The annual reports reviewed vary greatly in the detail provided about committees: some merely cite the names of the committees while others outline how committees are comprised, how members are selected, how often committees meet and their key responsibilities. Self-evidently, a basic list of committees gives readers very little understanding of what committees do and what value they deliver to the board.

There is little formal guidance on how frequently boards and committees should meet, even from the UK Corporate Governance Code. But it is however surprising that very few of the top 100 charities indicate how frequently their board and committees meet. Among FTSE 350 companies the average number of board meetings was 8.5 a year (with a range between 2 and 25) whilst Foundation Trusts hold an average of 11.1 full board meetings a year. If charities did disclose their number of meetings, it would help readers understand the commitment and engagement of the trustees with the charity.

DISCLOSURE ON COMMITTEES

What does good look like?

It should include:

- the name of each committee
- its key responsibilities
- meeting frequency
- how the committee reports to the main board
- the names of the trustees (and outside members) sitting on each committee
- why committee members are selected (for example, audit committees normally include a member with relevant audit experience)
- the attendance rates for each committee member.

Nomination committees

Most (80%) of the top 100 have an audit committee with 53% having a remuneration committee. However, when it comes to the recruitment of new trustees and the matching of skills and experience to the needs of the charity, it is difficult to see how the trustees are selected. The UK Corporate Governance Code requires companies to have a nominations committee, charged with recruiting new directors, with the majority of the members being independent non-executive directors. There is no such requirement for charities. We believe such a provision could help give boards greater diversity and a wider range of skills that might increase their effectiveness. Some organisations do disclose the existence of a nominations committee and its responsibilities. However, many charities do not disclose the recruitment procedures for new trustees, nor what the current trustees bring to the board, making it difficult for readers to understand this important aspect of governance.

We would encourage the sector to make more use of nomination committees. A nomination committee with clear terms of reference over the recruitment and selection of trustees allows a reflection on the skills of the existing board and an analysis of any skills gap which needs to be filled.

Rotation periods

Around 50% of the top 100 charities mention a rotation period for trustees, with three or four years being a typical tenure. Rotation periods enable those with voting rights to vote on re-appointments, which represents good practice. In 2012, the FTSE 350 moved to annual re-elections for all directors as it can bring fresh thinking and new perspectives to the board. It can also, with the right mix of rotation dates, still provide continuity. However, there is a danger that it could result in too much churn and loss of knowledge.

Voters have a role to play. In order to make informed choices, they should equip themselves with a full understanding of the charity itself, of what experience and value individual trustees bring to the board and of their commitment as evidenced through their attendance record.

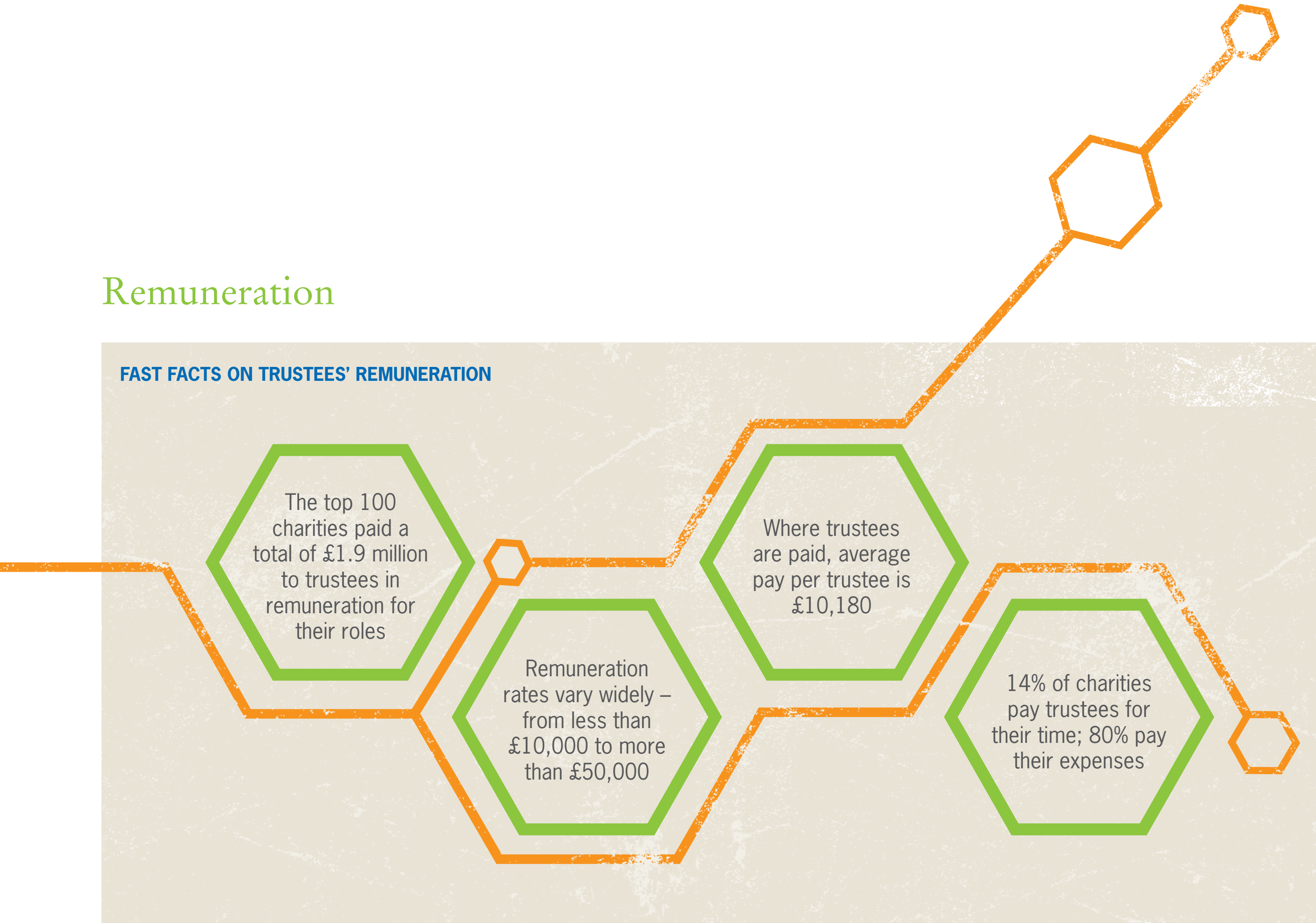
DISCLOSURE ON TRUSTEE SELECTION AND ROTATION

What does good look like?

It should:

- disclose how the trustees are selected
- explain why a trustee has been appointed/reappointed
- state the rotation period for trustees
- explain how trustees are appointed to the board.

Remuneration



Despite their significant responsibilities, most trustees are not paid for their time. There is an ongoing debate within the charity sector about whether trustees should be remunerated, with strong opinions on both sides. Those who argue for trustee remuneration believe it allows charities to recruit those who would not be able to afford to give their time unpaid, encouraging diversity of income brackets on a board. Lord Hodgson's July 2012 report, 'Trusted and Independent: Giving Charity back to Charities – Review of the Charities Act 2006' has increased public scrutiny and debate in this area.

"Unlike in the case of the directors of commercial companies, it is not the normal practice for charity trustees, or people connected with them, to receive remuneration, or other benefits, from the charities for which they are responsible, or from institutions connected with those charities. Detailed disclosures of remuneration and benefits are therefore required where the related party is a charity trustee, or a person connected with a charity trustee."

Paragraph 230, Charity SORP

Trustees' expenses

In contrast to remuneration for time spent, the Charity Commission encourages trustees to claim expenses so that those who cannot afford out-of-pocket expenses are still able to serve on boards.

Our review showed that 80% of the top 100 charities pay some or all of their trustees' expenses. The average claim per trustee was £2,858, although most trustees are paid less than £200. The vast majority of these expenses relate to travel. A concern is often raised that some trustees may feel unwilling to claim expenses, because their fellow trustees do not; by restricting the pool of trustees to those who can forgo out of pocket expenses, charities may, albeit unwittingly, be limiting the diversity of their boards.

"Where a charity has met individual expenses incurred by trustees for services provided to the charity, either by reimbursement of the trustee or by providing the trustee with an allowance or by direct payment to a third party, the aggregate amount of those expenses should be disclosed in a note to the accounts. The note should also indicate the nature of the expenses (eg travel, subsistence, entertainment, etc) and the number of trustees involved."

Paragraph 231, Charity SORP

"Ensuring that the opportunity to be a trustee is open to all is one of the keys to achieving strong, effective boards of trustees."

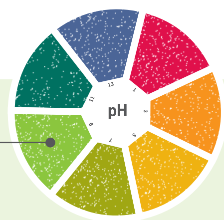
Trustee expenses and payments, Charity Commission guidance CC11

"The expectation and achievement of high attendance rates for committees and boards is also a marker of good governance."

Board effectiveness

A number of studies[3] have discussed the optimum board size for effective meetings. Most top 100 charity boards have from 10 to 15 members, the average being 13: this is at the high end of the range recommended in studies. The average FTSE 350 board has 9.5 members[4], approximately 25% lower than the top 100 charities.

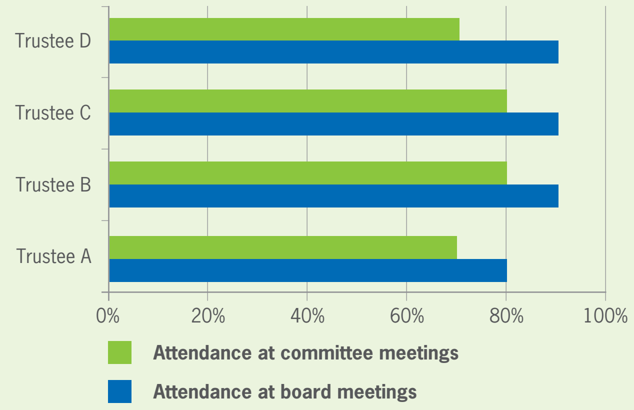
Most charity annual reports do not disclose an attendance rate for board meetings. This contrasts sharply with the FTSE 350 where more than 98% of companies give full details of the number of meetings and individual attendance rates. We recommend that charities make the same disclosures: it would give stakeholders greater insights into trustees' commitment and could encourage fuller attendance. The expectation and achievement of high attendance rates for committees and boards is also a marker of good governance.



DISCLOSURE OF ATTENDANCE

What does good look like?

Example layout for trustees' attendance record



[3] For example, A Modest Proposal for Improved Corporate Governance, Martin Lipton and Jay W Lorsch, 1992 and The Eversheds Board Report: Measuring the impact of board composition on company performance 2011

[4] The Chemistry of Governance: A Catalyst for Change – Grant Thornton, January 2013

Board evaluations

"Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years."

UK Corporate Governance Code, B.6.2

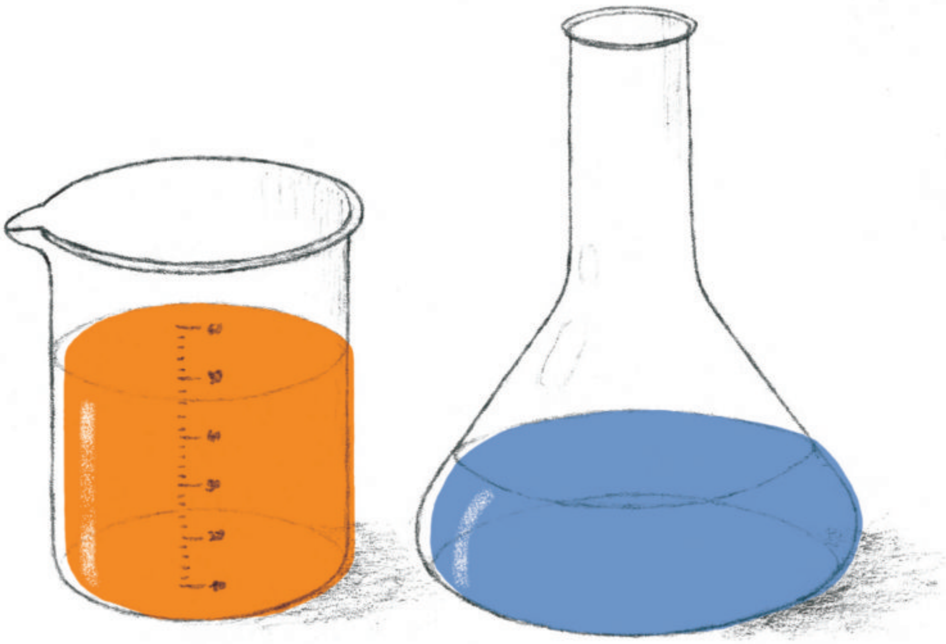
There is no requirement for a board's performance to be evaluated and reviewed; it is however considered to be best practice. It is perhaps unsurprising that a board would not wish to publish performance review findings, unless they are wholly positive, but it would be beneficial for stakeholders to be told at least how, and how often, boards appraise themselves.

Guidance for the corporate sector was introduced in 2003 at the recommendation of Higgs[5]. This was further developed in 2012 when the requirement for a triennial external evaluation was introduced. Many trustees, with roles on corporate boards, will be familiar with these requirements.

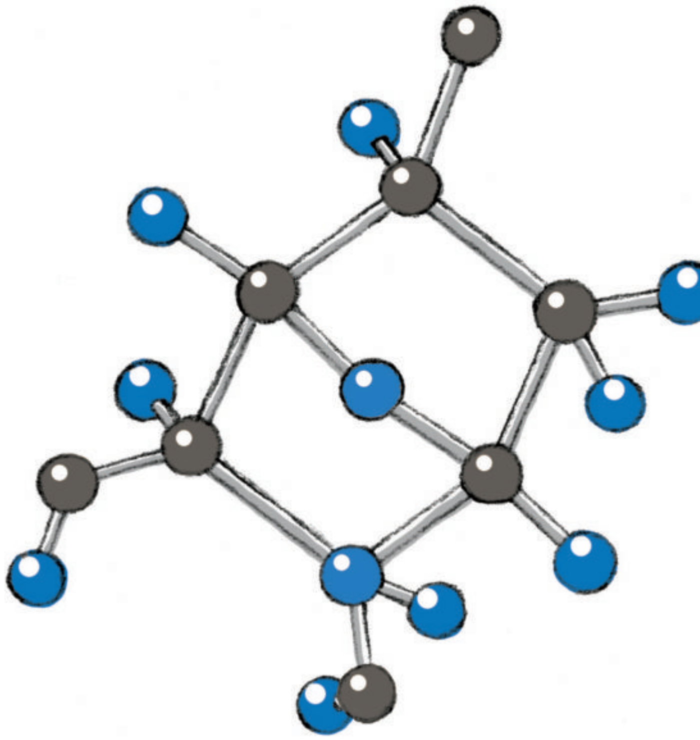
There may still be some resistance to board reviews, even if the findings are not disclosed, particularly among charities that do not pay their trustees. However, regardless of remuneration, if a trustee is willing to take on the responsibilities of the position, they should expect to do so in a professional way and be appraised accordingly.

"An effective charity is run by a clearly identifiable board or trustee body that has the right balance of skills and experience, acts in the best interests of the charity and its beneficiaries, understands its responsibilities and has systems in place to exercise them properly."

The Hallmarks of an Effective Charity, The Charity Commission



[5] The Higgs Report: Review of the role and effectiveness of non-executive directors 2003



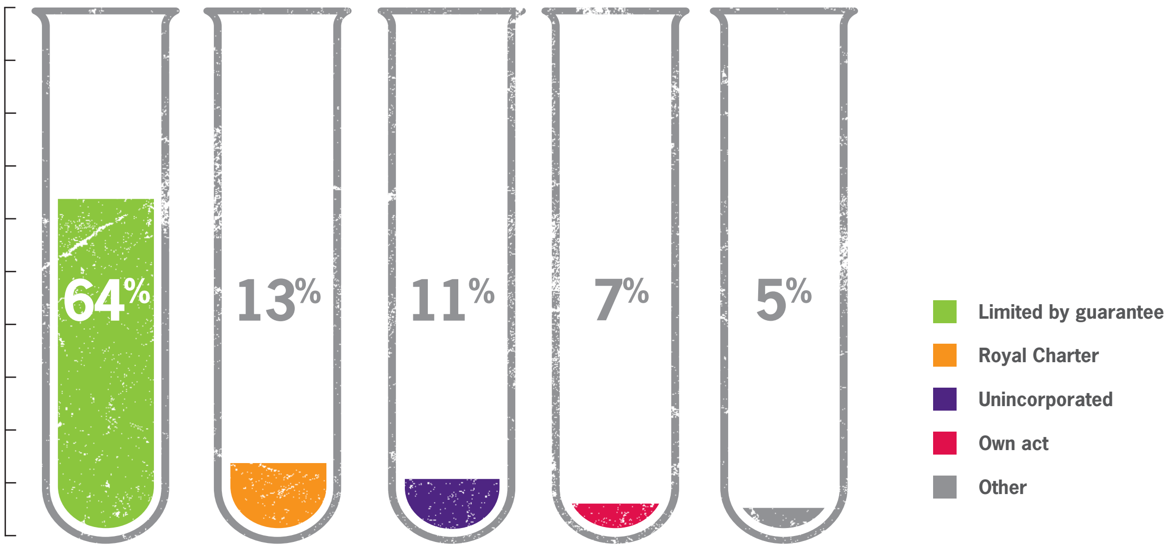
Structure

Eleven of the top 100 charities remain unincorporated bodies rather than companies limited by guarantee. As a consequence "trustees may be personally responsible for liabilities incurred by the charity[6]".

However, a charity may choose to be unincorporated structures where the charity's members want to hold its trustees accountable[7].

A new structure has recently been introduced, a charitable incorporated organisation (CIO), which aims to mitigate some of the risks of being unincorporated. It will be interesting to see how many unincorporated charities choose to become CIOs.

STRUCTURE



[6] Charity Commission CC3 – The Essential Trustee: What you need to know, March 2012

[7] Incorporating an existing charity as a company – Questions and answers, Charity Commission, October 2011

Reporting against objectives

The annual report provides an ideal platform for charities to present their aims and achievements and engage with stakeholders, but many organisations could make more of the opportunity.

Objectives

Charities are usually established with a small number of objectives which are summarised in their governing document. The stakeholders of the charity, whether they are the trustees, management, employees or funders should have a clear understanding of its objectives and ethos.

The annual report and financial statements, as an annual and public document, offers an opportunity for a charity to demonstrate transparency and garner trust with the public by disclosing how it is performing against objectives, using its funds and measuring its impact, and its plans for the future.

Impact reporting has been discussed for many years and a number of publications[8] give guidance on impact measurement. The level of reporting of impact within the annual reports reviewed varies widely. The majority of charities use key performance indicators (KPIs) as an effective way of demonstrating impact. However, 25% of the top 100 are now publishing separate impact reports on their websites which are readily accessible to the general public.

"Good reporting will explain what the charity is trying to do and how it is going about it."

Paragraph 36, Charity SORP

Many charities have evolved their objectives over decades in response to changing needs. Seventy-five per cent of the reports reviewed give a clear summary of the charity's main objectives. With large organisations that have diversified and expanded, there is the risk that the reports of results can become unfocused. Our review confirmed that the quality of the disclosure of results and aims varied widely, from those that include detailed analysis, case studies and photographs to those that use single paragraphs that closely resemble the corresponding section in the previous year's report.

PRESENTING CHARITY OBJECTIVES

What does good look like?

- Each separate objective is summarised in a clear, concise way
- A statement of progress is made against each objective. In most cases, this should be quantified
- An aspirational statement of planned progress is given for each objective for the coming year and into the future

[8] For example, Principles into Practice: How Charities and Social Enterprises Communicate Impact', CFG, NPC and ACEVO, and Impact Reporting in the UK Charity Sector, CFG and Cass Business School

Annual comparisons

The Charity SORP and the Companies Act 2006 require trustees to consider how their organisation has performed financially in the year. In response, a number of charities just summarise that year's surplus or deficit compared with the previous year. This provides very little insight into why a charity performed as it did, whether the board expected the result, if it was happy with performance and what is planned for the future. Such scant information also makes it difficult to review and explain trends over long periods.

To follow best practice, we believe that trustees should link financial performance to the charity's strategy and its investment and reserves policies and demonstrate their impact. Our review showed that 77% of the top 100 disclose how the charity peformed against its aims.

The following example provides a possible approach to summarising performance against a charitable objective.

EXAMPLE DISCLOSURE

Access to information

Our purpose

To expand access to relevant information to our stakeholders, offering free support to those who need it, wherever they are in England.

In last year's annual report we said we would

Expand our mobile information service to rural areas throughout England, so that those without easy access to hospital could access the information and support they need.

What we did

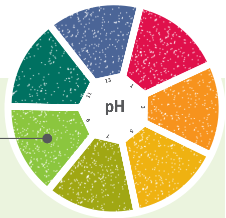
We purchased 20 additional mobile information centres in July 2011, which became fully operational in September 2011. Between September and December 2011, 17,012 people visited the vehicles, speaking to the on-board nurses and collecting information leaflets and contact details. These visitors were logged onto our database, with their consent. We used this resource to measure our involvement with them against five criteria, including satisfaction of support received and level of independent living. We also use this monitoring system to target our services appropriately.

Our impact

17,012 people have been able to speak with a member of staff, reducing the pressure on public services. As each GP appointment costs around £25[9], this saved £425,300 in public money in four months. We have been able to review clients' satisfaction with our support and now publish rolling quarterly satisfaction reports on our website. A case study of how we helped Jane, a recently diagnosed patient, is included on page xx of this report.

These vehicles, in addition to our existing fleet, means we are now able to reach 35% of the England's rural population each quarter.

[9] Source: NHS Institute for Innovation and Improvement



PERFORMANCE REPORTING

What does good disclosure look like?

It should include:

- a summary of what the charity aims to achieve
- how it measured its impact
- what it achieved in the year
- its plans for the future
- case studies that showcase individual projects or people helped.

The annual report offers a shop window for charities to demonstrate their progress against objectives and their successful impact. Some charities seize this annual opportunity whilst others publish separate impact reporting documents, made available on the charity's website. From our review of the top 100 charities' websites some of these reports appear to be updated infrequently. This raises the question of whether regular separate impact reporting is too great a burden for some charities.

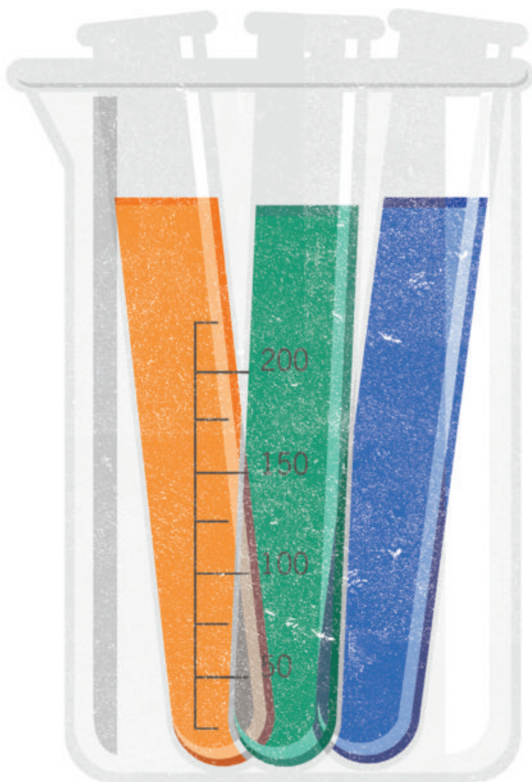
"To follow best practice, trustees should link financial performance to the charity's strategy and its investment and reserves policies."

"The report should contain information that enables the reader to understand and assess the achievements of the charity and its subsidiary undertakings in the year. It should provide a review of its performance against objectives that have been set. The report is likely to provide both qualitative and quantitative information that helps explain achievement and performance. It will often be helpful to identify any indicators, milestones and benchmarks against which the achievement of objectives is assessed by the charity."

Paragraph 53, Charity SORP

"A review of charitable activities undertaken that explains the performance achieved against objectives set. Where qualitative or quantitative information is used to assess the outcome of activities, a summary of the measures or indicators used to assess achievement should be included."

Paragraph 53a, Charity SORP



Understanding and managing risk

Identification and management of risk is integral to effective governance yet charities seem hesitant about disclosing their risk strategies and procedures.

A statement should be provided confirming that the major risks to which the charity is exposed, as identified by the trustees, have been reviewed and systems or procedures have been established to manage those risks.

Paragraph 45, Charity SORP

Understanding risk

A board needs a deep understanding of the key risks its charity faces so it can ensure that these are properly managed. With this understanding and a risk management toolkit in place, a board can concentrate on strategic planning and achieving the charity's aims without needing to 'fire-fight' if crises occur. Eighty-one per cent of charities gave a good level of disclosure in their annual reports of the key risks they face.

Use of risk committees

Many charities have a range of committees which cover specific areas of governance: 15% of the top 100 have a risk committee, with others including risk in the remit of another committee, most commonly the audit and risk committee. Although ultimate responsibility for risk must stay with the board, sub-committees help the board to focus on key risk issues, on risk review findings and give strategic direction on risk, rather than spending its limited time on detailed risk reviews. Currently 40% of non-financial FTSE 350 corporates and all financial services companies have a separate risk committee[10].

The 2009 Walker Review of 'Corporate Governance in Banks and other Financial Industry Entities' recommended that banks and life insurers introduce risk committees. The review increased the focus on risk management in other sectors: in the charity arena, it has spurred a debate as to whether organisations should separate responsibility for risk from the audit committee. There is no right or wrong answer as to whether or not a charity should establish a separate risk committee, or leave it within the remit of the audit and risk committee. But what is key is that boards are clear about the importance of their being engaged in decisions on key risks. The board must understand how they will be assured about the effectiveness of the charity's risk management arrangements.

[10] The Chemistry of Governance: A Catalyst for Change, Grant Thornton, January 2013

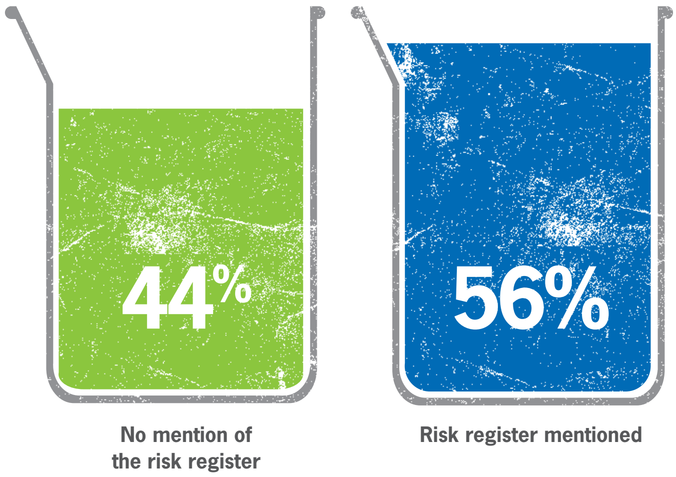
Principal risks and uncertainties

The Companies Act 2006 requires directors to consider the principal risks and uncertainties facing their organisation (unless their business qualifies for small company exemption). The Charity SORP requires a statement that the major risks to which the charity is exposed have been reviewed and systems are in place to manage them.

Such disclosure is intended to allow readers an understanding of the business and stewardship of the organisation. A detailed explanation of every risk in an organisation is not required. In reality many charities do not disclose the risks they face in great detail in their annual reports. This may be because of concerns that their peers could use the information disclosed for competitive advantage or that regulators and funders could pick up on issues which they would prefer to keep confidential.

In today's increasingly complex economic environment, risks evolve continuously: the regular consideration of risks and how they should be managed is key to the sound management of a charity. In charities, the most common method of documenting the management of major risks is through a risk register. A risk register can help effective communication between board and management as they review and consider their organisation's understanding of its key risks and develop appropriate mitigation strategies.

However, 44% of the top 100 charities do not mention a risk register in their reports, with only 25% stating how often it is reviewed. This lack of disclosure does not mean that charities are not using and updating their risk register. However, a more explicit statement would aid understanding.



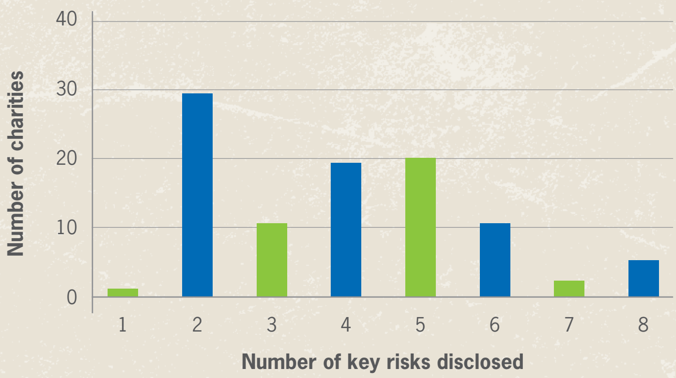
"A risk register can help effective communication between board and management as they review and consider their organisation's understanding of its key risks."

Disclosure of main risks

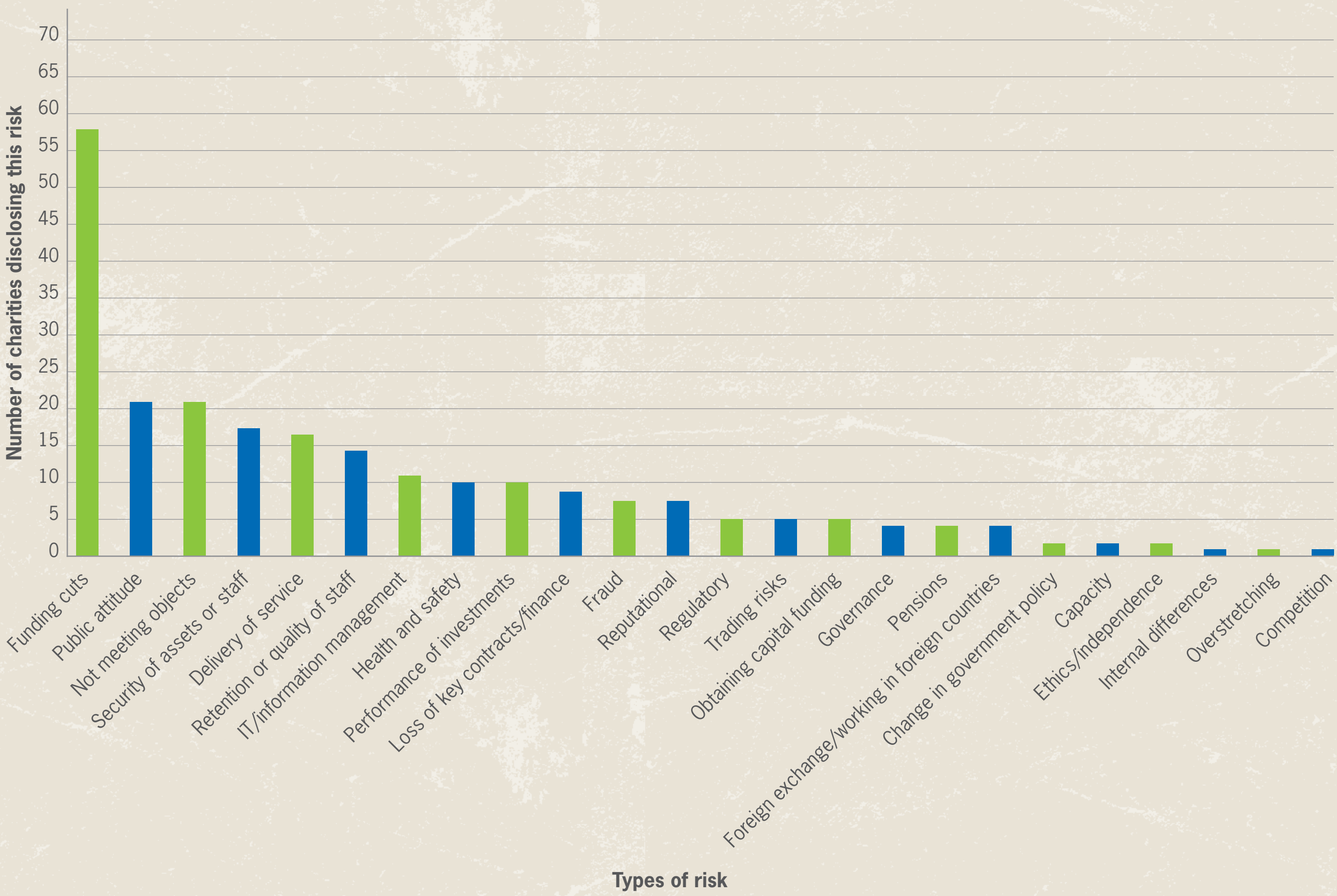
As the top 100 charities focus on a wide range of causes, from animal welfare to housing, so their types of organisation differ markedly: from entities funded by government to those supported by solely voluntary donations and legacies. The risks they face therefore vary considerably, although many are common sector-wide because of the way charities are funded and the countries in which they operate.

Our review of annual reports showed a number of key risks identified. Unsurprisingly, more than 35% of charities cited the recession as a key risk.

KEY RISKS



TYPES OF RISKS IDENTIFIED IN THE TOP 100 CHARITIES



"Identifying and managing the possible and probable risks that a charity may face over its working life is a key part of effective governance for charities of all sizes and complexity."

Charity Commission guidance, Charities and Risk Management

One of the most commonly identified risks disclosed is the risk of a cut in funding, whether in the form of donations, grants or government contracts. A recent report[11] suggests a 20% fall in the money donated to charity between 2010/11 and 2011/12, confirms their concern.

Few charities give any insight as to how they plan to address this risk nor the controls put in place to mitigate it. Similarly, 74% of the top 100 charities have limited going concern disclosures within their annual reports, other than the statutory requirement included within the trustees' responsibilities' paragraph.

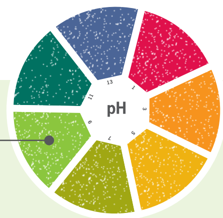
The Financial Reporting Council's 2009 guidance on going concern disclosures[12] states that, while the level of disclosure required varies depending on company size, directors should make "balanced, proportionate and clear disclosures about going concern for the financial statements to give a true and fair view".

With the closure of a number of charities in recent years, greater disclosure of how charities plan to fund themselves and how their boards plan to manage financially, may give comfort and understanding.

"Many charities have limited going concern disclosures within their annual reports, other than the statutory requirement included within the trustees' responsibilities' paragraph."

For charities which rely on individuals for a significant part of their funding, whether through donations or legacies, trust and reputations are paramount. The recent trustees' decision to close down Jimmy Savile's charities shows how vital public opinion can be. However, only 8% of the top 100 charities recognised reputational risk as a key risk. In such media sensitive times it seems a little surprising that reputational risk receives so little consideration. Perhaps boards will now put more emphasis on reputational risk in their coming reports.

A recent Charity Commission report[13] estimated that the cost to charities of fraud is 1.7% of annual charity income (£1.1 billion) per year. However, only 8% of the top 100 recognised key risks linked to fraud and as the Charity Commission figure relates just to frauds detected, should charities disclose more about how they manage this risk?



DISCLOSURE OF RISKS

What does good look like?

A robust disclosure will include:

- a summary of how they are managed
- details of how the risk management processes are controlled and how the board oversees the management of risk
- the statutory statement that risks have been considered and are being controlled.

[11] UK Giving 2012, NCVO and CAF, November 2012, NPC and ACEVO, and Impact Reporting in the UK Charity Sector, CFG and Cass Business School

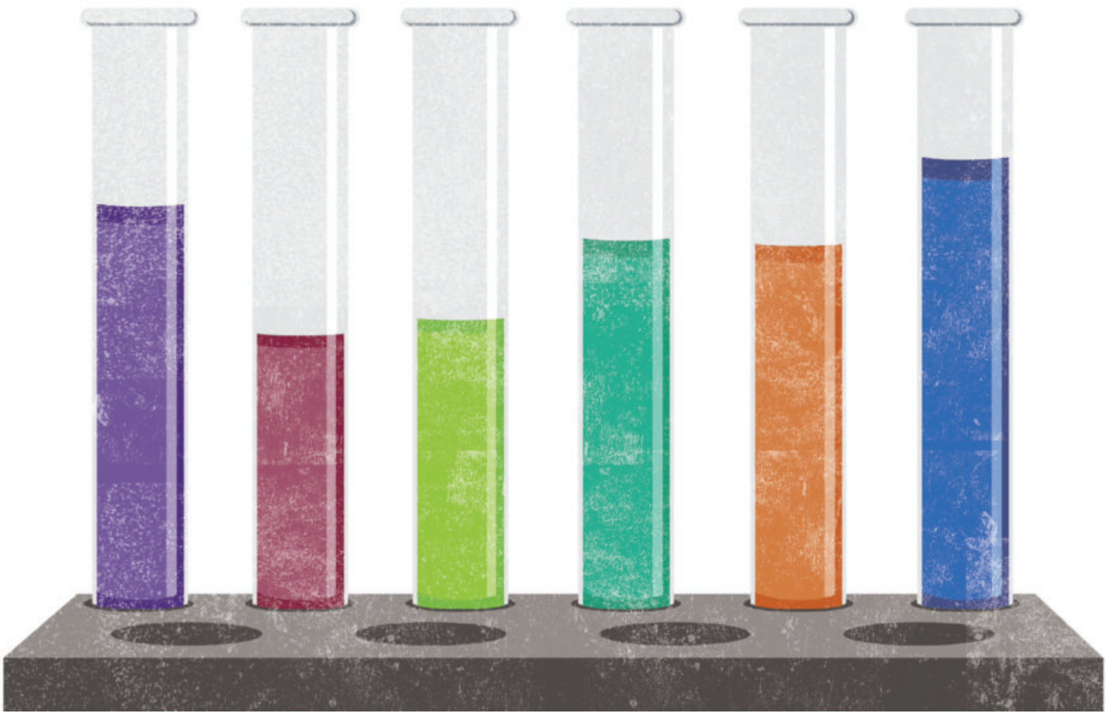
[12] Financial Reporting Council, Going Concern and Liquidity Risk: Guidance for Directors of UK Companies, October 2009

[13] National Fraud Authority Annual Fraud Indicator Report 2012, cited in the Charity Commission's strategy paper 'Our strategy for dealing with fraud, financial crime and financial abuse of the charity sector' published March 2012

AN EXAMPLE OF RISK MANAGEMENT DISCLOSURE

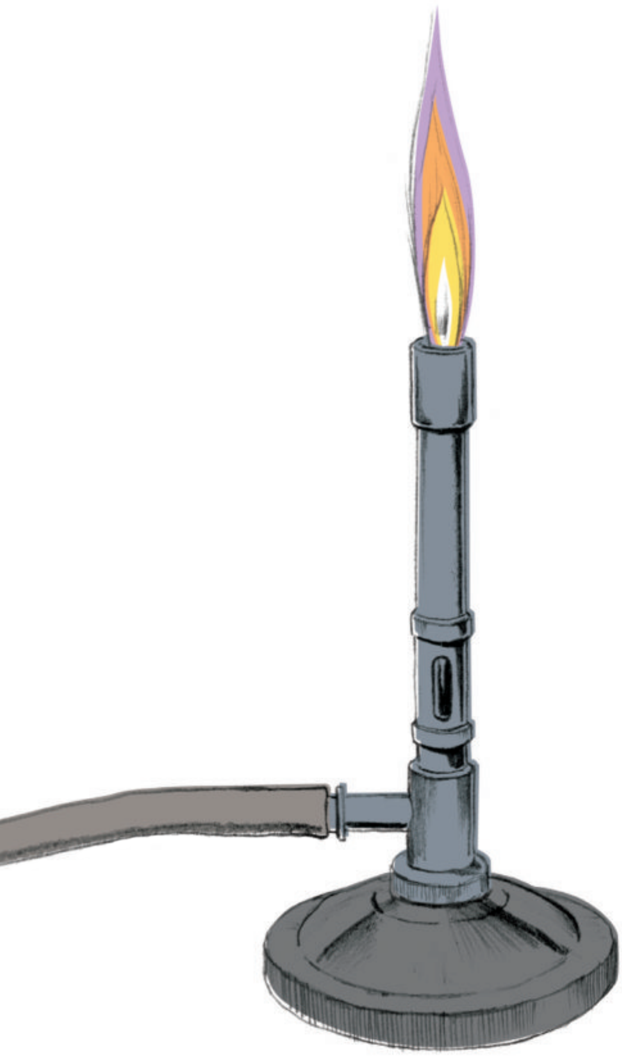
We operate a formal risk management process, where trustees and senior managers together identify top-level risks to the charity, their probability, impact and the consequent actions necessary to manage them. This process includes a corporate risk register which is reviewed quarterly. The key risks identified for the year-ended xxxx were:

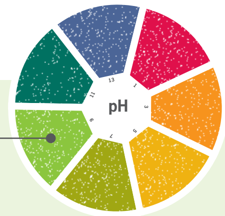
Objective	Risk	How we manage the risk
Provide facilities for the social welfare of children and young people in need	A serious protection incident causes harm to an individual and/or serious reputational damage to the charity, with legal and financial consequences	We have an inspection and quality-monitoring regime which acts on any quality and protection issues
To deliver our services to our core beneficiaries	A reduction in voluntary contributions leaving us insufficient income to meet our needs and objectives	We prepare monthly management accounts and five-year budgets and forecasts to monitor our financial position so action can be taken on a timely basis
To deliver our services to our core beneficiaries	A reduction in grants from our funders that reduces our income to a level that impacts the delivery of our services	We meet regularly with our funders and should have early warning of any reduction in funding



Reserves' policies

A charity's reserves' policy goes hand-in-hand with its working capital and resource management. The Charity Commission requires charities to disclose how they seek to manage their reserves. Our review of the financial statements of the top 100 charities shows a variation in the quality of disclosure. This ranges from just a heading for 'reserves' policy' above a sentence that a policy exists to detailed disclosure of how often the policy is reviewed and the different types of reserves held.





RESERVES' POLICIES

What does good look like?

An example policy:

We continue to emphasise prudent management of our reserves and long-term financial planning, including a rolling five-year budget. This is particularly important in the current economic climate, with uncertainties over funding levels and voluntary donations.

The trustees have an approved reserves' policy, which is reviewed at least annually by the full board. The policy is designed to retain at least three months of unrestricted free reserves (amounting to £x) to cope with unforeseen expenditure or loss of income. We consider free reserves to be income which has not been spent, designated or committed.

The actual level of reserves is reviewed regularly. If the level is expected to move outside our policy range we would take action to resolve the situation. At the date of this report our free reserves are £x and are thus within our prescribed range of reserves.

The charity currently holds the following reserves:

- Unrestricted reserves, which include fixed assets of £x for use within the organisation. At the year-end these amounted to £xx (prior year: £xx). The increase of £xx relates to an operating surplus of £xx
- Restricted reserves, which relate to bursary funds of £xx (prior year: £xx) and can only be used for the bursaries to which they were donated

Full details of the individual restricted funds included in the above balance can be found in note xx to the financial statements.

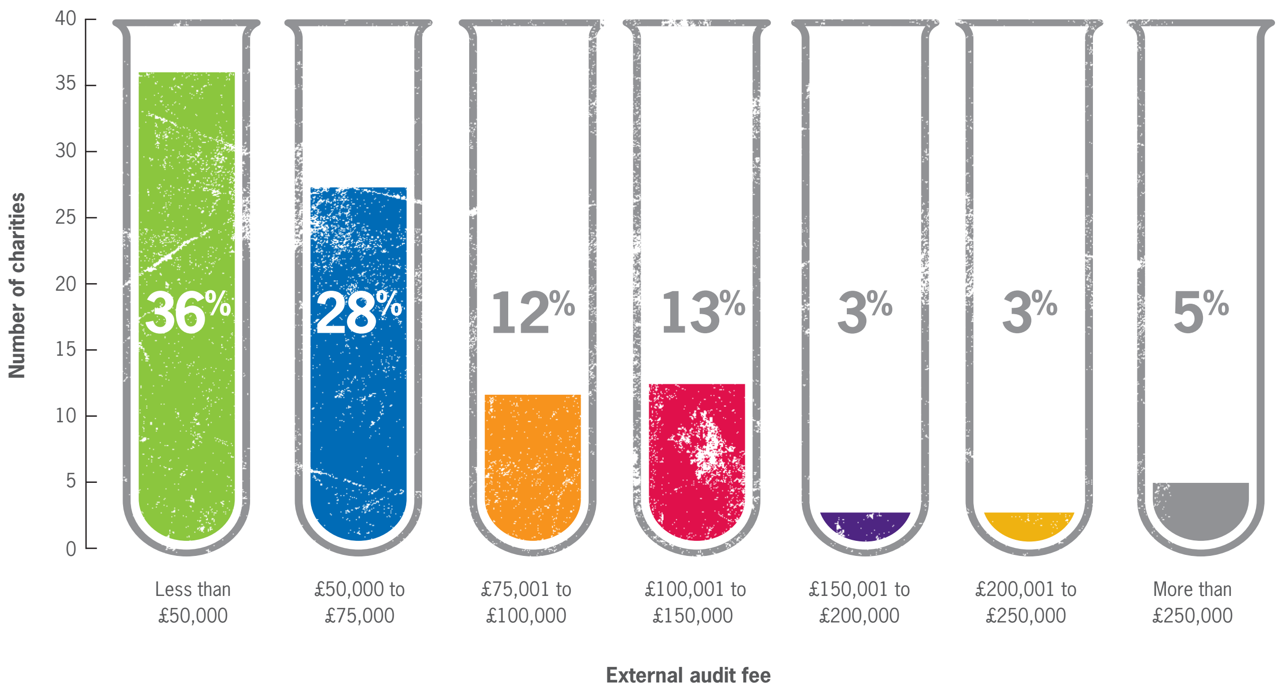
Assurance

External audit

The debate about whether auditors should undertake non-statutory services is gaining momentum, driven by regulator and investor concerns over the choice in the listed company audit market. Perspectives range, on one side, from audit committees being able to set appropriate parameters to, on the other, auditors being barred from undertaking such services and the creation of audit-only firms. The FRC Guidance on Audit Committees[14] suggests that the external auditor's independence and objectivity and the effectiveness of the external audit is monitored. Disclosure of this information in the trustees' report would give the users of the accounts the sense of how long the auditors have been engaged, the other services provided and ultimately whether auditor independence has been compromised.

Charities vary significantly in whether they use their auditors for non-statutory services. Forty per cent of the top 100 pay no non-audit fees to their external auditors. At the other end of the scale there are 10 charities whose non-audit fees were greater than their audit fees. The average of non-audit fees as a percentage of audit fees is 41%.

AUDIT FEES



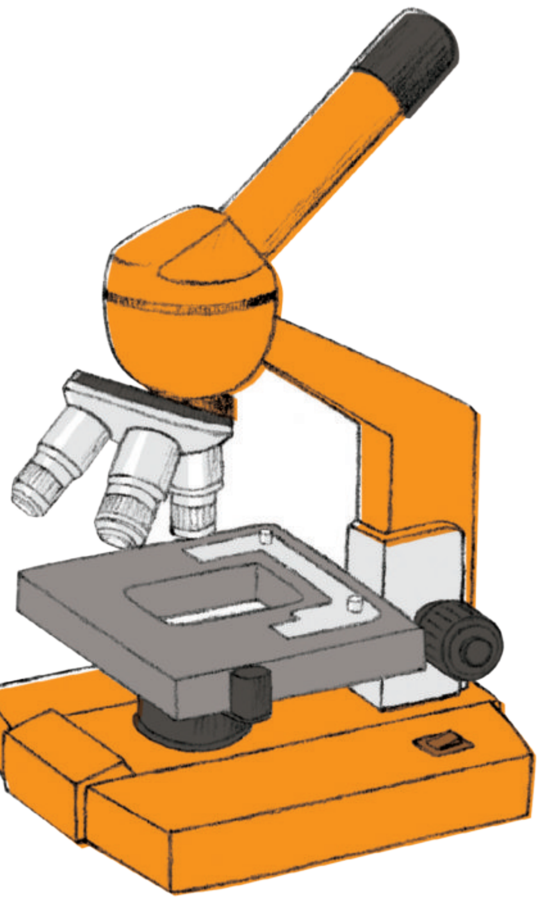
[14] FRC Guidance on Audit Committees, September 2012

Our review found the external audit fee charged in the top 100 varies widely, with an average of £80,000, less than 10% of the average governance costs of £833,000.

Internal audit

Despite the important role internal audit can play in supporting risk management, there is no requirement for a charity to disclose whether it has an internal audit function and, if it has, whether it is in-house, outsourced, or a mix of the two. Our review shows that more than 70% of the top 100 charities mention an internal audit function in their annual report, with 31% disclosing that the function is outsourced. It would be useful for those who do not have an internal audit function to disclose why they have chosen not to have an internal audit function and for those that have an in-house function providing greater disclosure over the level of resource committed to this department. All FTSE 100 companies have an internal audit function, with 89% of the FTSE 350 disclosing the use of one.

The Turnbull report “Internal control: guidance for directors” was issued in 1999 and revised in 2005. This is expected to be reviewed during 2013. This provides useful guidance to link strategy to mitigating controls and provides a number of good examples which could be used by internal auditors within the sector.



About us

We are Grant Thornton UK LLP

Dynamic organisations know they need to apply both reason and instinct to decision making. At Grant Thornton, this is how we advise our clients every day. We combine award-winning technical expertise with the intuition, insight and confidence gained from our extensive sector experience and a deep understanding of our clients.

Through empowered client service teams, approachable partners and shorter decision-making chains, we provide a wider point of view and operate in a way that's as fast and agile as our clients. The real benefit for dynamic organisations is more meaningful and forward-looking advice that can help unlock their potential for growth.

In the UK, we are led by more than 200 partners and employ over 4,000 of the profession's brightest minds, operating from 27 offices. We provide assurance, tax and specialist advisory services to more than 40,000 clients, public interest entities and individuals nationwide.

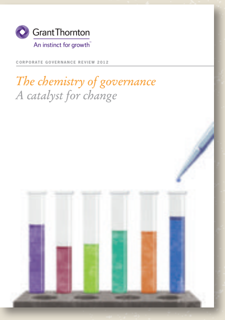
Grant Thornton in the charity sector

Grant Thornton's national charity team provides bespoke audit, tax and other advisory services to many charities operating in the UK and overseas. Ranked third by income audited, the national audit team was also awarded 'Audit Team of the Year' by Accountancy Age in 2010 for services to the not for profit sector. Grant Thornton's accredited charity specialists work from eight regional locations to ensure our clients are serviced by knowledgeable staff who are kept abreast on all charity sector and technical issues as they arise.

Bringing international experience to bear

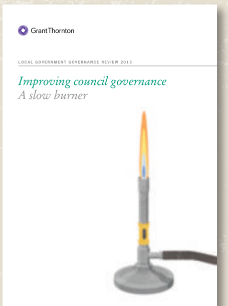
Grant Thornton UK LLP is a member firm of Grant Thornton International Ltd (Grant Thornton International). With other Grant Thornton member firms, we are committed to providing an international perspective on the challenges our clients face in delivering high quality services, while managing their limited financial resources. We support charity clients by monitoring market developments in other jurisdictions, advising on best practice and drawing on bespoke skills and experience from other member firms.

Governance matters



Corporate Governance Review 2012

NHS Governance Review 2013



Local Government Governance Review 2013

Charity Governance Review 2013

For further information, visit:
www.grant-thornton.co.uk/governancematters

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