



# **Private Action, Public Benefit**

## A Review of Charities and the Wider Not-For-Profit Sector



# CONTENTS

|  |           |
|--|-----------|
| <b>Foreword by the Prime Minister</b>  | <b>5</b>  |
| <b>Executive Summary</b>   | <b>7</b>  |
| <b>1 Introduction</b>  | <b>11</b> |
| Consultation document  | 11        |
| Origin and remit of the study  | 11        |
| Links to other work  | 12        |
| Coverage of devolved administrations   | 12        |
| Methods  | 12        |
| Recommendations  | 12        |
| Financial implications   | 12        |
| <b>2 The size and shape of the charitable and wider not-for-profit sector</b>                                  | <b>13</b> |
| What's in a name?  | 14        |
| Overview of the sector   | 14        |
| Charities  | 18        |
| The non-charitable not-for-profit sector   | 24        |
| Corporate social responsibility  | 24        |
| Legal forms taken by charities and other not-for-profit organisations  | 25        |
| The current system of regulation   | 26        |
| <b>3 Developing the sector's potential</b>   | <b>28</b> |
| The sector makes an important contribution to national life  | 29        |
| There are still barriers to the sector achieving its full potential  | 29        |
| The review should be based on the following principles and goals   | 30        |
| The Government's strategy should be to help realise the sector's potential, whilst respecting its independence | 31        |



|  |           |
|--|-----------|
| <b>4 Reforming the legal framework: a modern approach to charities focusing on public benefit</b>                                  | <b>35</b> |
| The current definition of charitable status  | 36        |
| Difficulties with the current definition   | 37        |
| Objectives for reforming charitable status   | 38        |
| Emphasising public benefit   | 38        |
| Encouraging entrepreneurialism   | 43        |
| Enabling charities to advocate effectively   | 45        |
| Providing flexibility to evolve  | 46        |
| <b>5 Reforming the legal framework: a range of legal forms enabling charities and other not-for-profit organisations to thrive</b> | <b>49</b> |
| Why incorporate at all?  | 50        |
| Forms of incorporation for social enterprises  | 50        |
| The Community Interest Company   | 53        |
| Bringing the Industrial & Provident Society up to date   | 55        |
| Getting social enterprise recognised   | 57        |
| A new legal form for charities   | 57        |
| <b>6 Building public trust and confidence and supporting the sector in improving performance</b>                                   | <b>59</b> |
| Promoting public trust   | 60        |
| Improving information provision  | 61        |
| Improving accountability   | 64        |
| Preventing fraud   | 64        |
| Better regulation of fundraising   | 65        |
| Helping charities and other not-for-profit organisations to improve their performance  | 68        |
| Measures to encourage trusteeship  | 69        |



|  |           |
|--|-----------|
| <b>7 Ensuring independent, open and proportionate regulation</b>     | <b>71</b> |
| The regulation of charities  | 72        |
| Charity Commission objectives  | 73        |
| Regulator’s characteristics  | 74        |
| Regulator’s functions  | 77        |
| Registration of charities  | 77        |
| Regulator’s funding, form and status                                 | 82        |
| Devolved administrations   | 83        |
| Appeals against regulator’s decisions                                | 83        |
| Rules on registration  | 85        |
| The impact of regulation   | 88        |
| Role of the Attorney General   | 89        |
| <b>8 Implementation</b>  | <b>90</b> |
| The role of the sector   | 90        |
| The role of government: a new approach in Whitehall                  | 91        |
| Legislation  | 91        |
| <b>Annexes</b>   | <b>92</b> |
| 1. Project team, Sponsor Ministers, Advisory Group                   | 92        |
| 2. Summary of recommendations  | 93        |
| 3. The Code of Practice on Written Consultation                      |           |
| 4. Role of the Strategy Unit   |           |
| 5. Regulatory Impact Assessment                                      |           |
| 6. Table showing earlier reviews of the sector                       |           |
| 7. Terms of reference of related initiatives eg cross-cutting review |           |

(Annexes 3-7 can be found on the Website on  
[www.strategy-unit.gov.uk/2001/charity/main.shtml](http://www.strategy-unit.gov.uk/2001/charity/main.shtml))

## FOREWORD BY THE PRIME MINISTER



In the modern world it is simply not possible to have a dynamic and vibrant society and economy without a dynamic and vibrant voluntary sector.

While other countries are seeking to build up independent not-for-profit organisations from a very low base we in the UK are fortunate in benefiting from the enterprise and energy of an extraordinary range of charities and other not-for-profit organisations which provide services and care, mobilise communities, and help to identify and solve new needs as well as old ones.

We are also fortunate in that we benefit from such a long and rich history of charitable activity. Our sector today includes large household-name charities, community groups, self-help organisations, religious bodies, and fair-trade businesses paying farmers in developing countries a better price for their goods. It has steadily grown in size and influence by harnessing the spirit of community and the benevolent instincts of human nature.

Wise governments respect the crucial independence of the sector. But government has an important role to play in providing support. We have already taken steps to help the sector, including tax changes to support charitable giving, the introduction of the Compact on relations between government and voluntary organisations, and working in partnership on initiatives such as the National Strategy for Neighbourhood Renewal. Most recently, the cross-cutting review has sought ways to overcome the barriers that make it hard for not-for-profit organisations in the sector to deliver high-quality public services and engage in partnership with the public sector.

But more needs to be done. Much of the legal context for charity and voluntary action is now outdated. In some areas excessive red tape is preventing the sector from fulfilling its true potential. And sometimes the rules risk undermining public confidence.

That is why I asked the Strategy Unit to take a look at the law and the regulatory structures which govern the whole sector. This has been a major undertaking, which was only possible thanks to the enthusiastic input of the sector throughout the review.

The comprehensive analysis underlying this report shows that law and regulation have not kept pace with developments. Charitable purposes, for instance, were set out in a statute over 400 years ago. The current law is unclear, has not evolved in a way which best meets the needs of contemporary communities, and does not reflect the diversity of

organisations which operate for the public benefit. There is also insufficient recognition in the legal system of the particular needs of social enterprises, a rapidly growing group of businesses carrying out a wide range of activities for the benefit of society rather than the individual.

This report sets out a package of measures which will modernise the law and enable a wide range of organisations to be more effective and innovative, whilst maintaining the high levels of public trust and confidence which are vital to the continued success of the sector.

The report is issued as a consultation document. Over the next three months, there will be time to comment on the analysis and the proposals in this report. I want to work with the sector and I hope to hear views from the widest possible range of people and organisations.

A handwritten signature in black ink that reads "Tony Blair". The signature is written in a cursive style and is underlined with a single horizontal line.

## EXECUTIVE SUMMARY

### The importance of charities and the wider not-for-profit sector

Charities and the wider not-for-profit sector make very important economic and social contributions to society as a whole. They provide vital services and strengthen communities. There are considerable benefits to society in having a not-for-profit sector which is prosperous, growing, and identifying new needs.

The sector comprises around 600,000 organisations, including 188,000 registered charities. Tens of thousands of other charities are not required to register. In recent years, the sector has grown in income, number of organisations, and employment. However the sector faces a number of challenges which prevent it from achieving its full potential.

### The independence of the sector and the role of government

The sector's independence is vital to its success. But Government has an important role to play in setting the framework within which the sector operates. The Government wants to support a not-for-profit sector which is modern, dynamic, innovative, accountable, and engages with diverse communities.

The Government's strategy towards charities and the wider not-for-profit sector aims to:

- help organisations play a bigger role in revitalising communities and empowering citizens;

- encourage public support;
- help the sector to become more effective and efficient; and
- enable the sector to become a more active partner with Government in shaping policy and delivery.

### The changing context

The Government has already promoted support for the sector through the Compact on relations between government and voluntary organisations; tax changes to encourage charitable giving; initiatives on volunteering; and closer partnerships between central and local government and the sector on initiatives such as the National Strategy for Neighbourhood Renewal.

Building on these reforms, the Government has undertaken three complementary reviews to help the sector achieve its full potential. These cover:

- the legal and regulatory framework for charities and the wider not-for-profit sector (led by the Strategy Unit);
- the role of the voluntary sector in public service delivery (led by HM Treasury as part of the 2002 Spending Review); and
- improving access to public regeneration funding (led by the Regional Co-ordination Unit).

This review covers the first issue. The Government published a report on the other reviews in September 2002 – 'The Role of the Voluntary and Community Sector in Service Delivery'.





## Objectives of the Strategy Unit review

This review considers how to improve the legal and regulatory framework to enable existing organisations to thrive, to encourage new types of organisations to develop, and to ensure public confidence. The review sets out – for consultation – a package of proposals for reform which aim to:

- modernise charity law and status to provide greater clarity and a stronger emphasis on the delivery of public benefit;
- improve the range of available legal forms enabling organisations to be more effective and entrepreneurial;
- develop greater accountability and transparency to build public trust and confidence; and
- ensure independent, fair and proportionate regulation.

The main recommendations in each of these areas are set out below.

## Modernising charity law...

The law on charitable status is outdated and unclear. It excludes some types of organisation which clearly provide public benefit. This review proposes a number of legal reforms.

### *...by updating and expanding the list of charitable purposes...*

A charity should be redefined as an organisation providing public benefit which has one or more of the following ten purposes:

1. The prevention and relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. The advancement of health.

5. Social and community advancement.
6. The advancement of culture, arts and heritage.
7. The advancement of amateur sport.
8. The promotion of human rights, conflict resolution and reconciliation.
9. The advancement of environmental protection and improvement.
10. Other purposes beneficial to the community.

### *...requiring a clearer focus on public benefit...*

There should be a clearer focus on public benefit. In particular charities which charge large fees for their services, thereby excluding a substantial part of the population, will need to demonstrate how their activities have a public character. The Charity Commission should have an on-going programme to review the public character of charities.

### *...encouraging entrepreneurialism...*

Charities increasingly seek entrepreneurial ways to secure a sustainable income. This review proposes to provide greater freedoms by removing the requirement for trading charities to establish separate trading subsidiaries.

### *...enabling charities to campaign...*

Charities perform a valuable role in campaigning for social change. The guidelines on campaigning should be revised to encourage charities to play this role to the fullest extent.

### *...and cutting red tape.*

Some legal obstacles inhibit charities from modernising their constitutions, merging with others, or using their endowments in different ways. A package of deregulatory measures is proposed to give charities greater flexibilities.



## **Improving the range of legal forms available to charities and social enterprises...**

There are no corporate legal forms designed specifically for charities. Those available to social enterprises are often not well suited to their needs, because they neither protect assets nor offer a strong identity in which the public and funders can have confidence.

### ***...by creating Community Interest Companies...***

This review proposes a new legal form for social enterprise - the Community Interest Company. This would improve access to finance, create a strong new brand, be legally protected from demutualisation, and preserve assets and profits solely for social purposes.

### ***...modernising the law on Industrial and Provident Societies...***

The Industrial and Provident Society is an under-used form. It should be strengthened and up-dated by enabling Societies to opt for protection from demutualisation, and by renaming them as either Co-operatives or Community Benefit Societies.

### ***...and introducing the Charitable Incorporated Organisation.***

Many charities choose to incorporate as Companies Limited by Guarantee, but this legal form was not designed for charities and does not differentiate clearly the requirements of company law and charity law. Introducing the Charitable Incorporated Organisation, a new form specifically for charities, should remove these difficulties.

## **Developing greater accountability and transparency...**

Public trust and confidence enable charities and the wider sector to thrive and prosper. But for some there are few external pressures to improve performance. And accountabilities to beneficiaries and donors can be unclear.

### ***...by improving information available to the public...***

In general the sector does not produce sufficiently accessible and relevant information to meet the public's needs. This report proposes higher standards of information provision, including a Standard Information Return in which larger charities will focus on their objectives and measure outcomes against these. It encourages benchmarking, social audit and other quality tools through sector-led initiatives with Government support.

### ***...and regulating fundraising more effectively.***

Fundraising is the public face of the sector and can strongly influence public attitudes. A simplified licensing system for public collections should be introduced. A new self-regulatory initiative, overseen by a new independent body, should be developed to promote good practice in fundraising.

## **Ensuring independent, open and proportionate regulation...**

The regulation of charities should aim to:

- increase public trust and confidence;
- ensure compliance with charity law;
- enable and encourage charities to maximise their social and economic potential; and
- enhance accountability to donors and beneficiaries.



### ***...by updating the rules on registration...***

Accountability for the smallest organisations is best ensured at the local level, but standard regulation can be excessive for the smallest organisations. There should be higher thresholds for registration with the Charity Commission, and a new status of “Small Charity” for those which are too small to register.

Some large charities are currently not required to register with the Charity Commission. To achieve greater accountability for voluntary funds, these charities should be monitored for compliance with charity law by their existing sector regulator – or, where necessary, by the charity regulator.

### ***...and giving the Charity Commission clearer goals and greater accountability...***

The Charity Commission regulates charities in England and Wales. The review proposes consolidating recent improvements in its performance and ensuring greater accountability through establishing:

- clear statutory objectives against which it regularly reports;
- open public Board meetings and an Annual General Meeting;

- an enlarged Board to include a wider range of stakeholders;
- a new status as a statutory corporation called the Charity Regulation Authority;
- a new independent tribunal to enable trustees to challenge its decisions at reasonable cost; and
- reports, carried out with sector participation, of performance in particular areas of charitable provision.

## **What happens next**

The Government would welcome views on this consultation paper. Responses should be sent by e-mail to [piuvolsect@cabinet-office.x.gsi.gov.uk](mailto:piuvolsect@cabinet-office.x.gsi.gov.uk) or in writing to Strategy Unit/Home Office (Charities Project), Admiralty Arch, The Mall, London SW1A 2WH. The deadline for submissions is 31st December 2002.

The Home Secretary has responsibility for Charity Law in England and Wales. However, some of the issues in this report, such as the definition of charitable status, have implications throughout the UK. Following the consultation period in this report the Home Secretary will publish a Paper setting out the Government’s next steps.

# 1. INTRODUCTION

## Consultation document

1.1 This report is a consultation paper. Comments can be submitted by e-mail to [piuvolsect@cablnet-office.x.gsi.gov.uk](mailto:piuvolsect@cablnet-office.x.gsi.gov.uk) or in writing to Strategy Unit/Home Office (Charities Project), Admiralty Arch, The Mall, London SW1A 2WH. The deadline for submissions is 31 December 2002. As part of the consultation, the Home Office and Strategy Unit will jointly hold a number of consultation events across the UK, and meetings with representative bodies. The consultation is open to anyone who wishes to comment. Views are sought specifically on the report's recommendations.

1.2 The consultation process will adhere to the Code of Practice on Written Consultations, which is reproduced in Annex 3. Various papers (indicated with an asterisk), which address some issues in greater detail, support the report. They constitute part of the consultation. These can be found on the Website on [www.strategy-unit.gov.uk/2001/charity/main.shtml](http://www.strategy-unit.gov.uk/2001/charity/main.shtml) or may be requested in hard copy from the address or e-mail address above.

## Origin and remit of the study

1.3 The charities and wider not-for-profit sector contributes much to the health and dynamism of society. Government recognises that the key to the sector's success is its independence from Government. However, Government has a role to play in creating an environment in which the sector can thrive by, for example, providing a sound legal and regulatory framework which encourages entrepreneurialism and growth.

1.4 The Prime Minister announced this project on 3rd July 2001. The project's remit was to:

- comprehensively map the wider not-for-profit sector;
- clarify Government's strategy towards the sector;
- set out the principles which should underpin a reformed legal and regulatory framework;
- against this background, review the legal and regulatory framework for the sector in order to assess how it can better enable existing organisations to thrive and grow, encourage the development of new types of organisations, and ensure public confidence;
- review which types of organisations should have special status
- make recommendations for the removal of any unnecessary legal restrictions on investment, entrepreneurial activities, mergers and acquisitions; and
- make recommendations on modernising the regulatory framework for charity and the not-for-profit sector.

1.5 \* The paper **Scoping Note** sets out in more detail the background to the project, including Government policy to date, the case for the review and details of the existing legal and regulatory framework.



## Links to other work

1.6 This review accompanies two other related Government studies: a review of access to government regeneration funding, undertaken by the Regional Co-ordination Unit of the Office of the Deputy Prime Minister; and a cross-cutting review of public service delivery by the voluntary sector, led by the Treasury. Their findings were reported in September 2002 – ‘The Role of the Voluntary and Community Sector in Service Delivery’.

## Coverage of devolved administrations

1.7 Under UK law, the tax relief associated with charitable status is a reserved matter and the Inland Revenue is responsible for establishing charitable status for tax purposes in Scotland and Northern Ireland and for some charities in the rest of the UK. The supervision and regulation of charities have been devolved to the Scottish Executive (Scottish Charities Office) and to the Northern Ireland Assembly (the Charities Branch in the Department for Social Development). Recommendations on charity supervision and regulation therefore concern England and Wales alone.

## Methods

1.8 The project team (Annex 1) comprised a mix of civil servants and non-civil servants, experts in voluntary sector law, administration

and policy and non-experts. It was supported by an Advisory Group.

1.9 The project gathered information using a range of methods. There were meetings with representative bodies, expert seminars, international visits, and six regional and national consultation events organised through umbrella bodies. Papers were published on the Strategy Unit website: the project scoping note, papers setting out key questions addressed by the review, principles underlying the review, a mapping of the sector, options for reforming charitable status, the law on campaigning, and the charitable incorporated organisation. Comments were invited on work as it developed. Several hundred written submissions were received.

## Recommendations

1.10 Report recommendations are indicated in **bold italics**. A summary is given in Annex 2.

## Financial implications

1.11 Some recommendations in this report may demand additional resources from Government, or a re-setting of other expenditure priorities. These resource implications will need to be considered in the light of responses to the consultation. Costing of some recommendations will require more detailed work before Government can take final decisions.



## 2. THE SIZE AND SHAPE OF THE CHARITABLE AND WIDER NOT-FOR-PROFIT SECTOR

### Summary

- The charitable and wider not-for-profit sector is the collective term used in this report to describe charities, community groups, voluntary organisations, social enterprises and some mutual organisations. These organisations all pursue social aims and do not distribute assets to external stakeholders.
- The charitable and wider not-for-profit sector is both economically important and extremely diverse: it encompasses organisations of widely varying scale, purposes and structure.
- Within the sector, there are 188,000 registered charities in England and Wales and many tens of thousands more which are unregistered, together with many in Scotland and Northern Ireland. The number of registered charities is growing by around 1,800 a year, with employment in the sector growing strongly in recent years.
- Charitable income in recent years has increased most rapidly in larger charities with strong brands.
- The number of social enterprises (largely self-financing organisations which trade for a social purpose) grew by 9% in 2000. They are an increasingly important and dynamic part of the sector, and one with considerable potential.

This chapter provides an overview of:

- terminology used in describing the charitable and wider not-for-profit sector;
- the sector's scale, structure and diversity;
- the size of charities and recent trends in their sources of income;
- the scale of non-charitable not-for-profit organisations;
- the level of corporate social responsibility;
- legal forms used by not-for-profit organisations and recent trends in their use; and
- the principal forms of regulation.

## What's in a name?

2.1 Charities have a strong public image. Just knowing that an organisation is a charity is often enough to give the public confidence to donate money to it. A recent survey<sup>1</sup> found that two-thirds of respondents had high confidence in charities, more than had confidence in the legal system or the church.

2.2 However, it is much more difficult to find a term which captures the full range of organisations which are being discussed in this paper. Their uniting thread is that they operate for the primary aim of serving a community or for a social purpose, not for making a profit for investors.

2.3 Traditionally, the term 'voluntary sector' has been used. This is a reasonable way to describe charities, most (but not all) of which are overseen by an unpaid board of trustees, and many of which also have other volunteer input, and some other voluntary organisations. However, as the sector becomes more entrepreneurial, the term only really captures one element of their activity. It is even harder to see how the term has any relevance to co-operatives and social enterprises, which often have no voluntary input. The term 'voluntary and community sector' captures some additional community organisations, but is still not comprehensive.

2.4 The phrase 'Third Sector' has also been fairly widely used. Although it marks out the sector as something different from both government and business, it does little to define the sector itself and is unlikely to be well recognised by the general public.

2.5 A term which captured the distinctive purpose of these organisations would be preferable. There are two ways to do this. One is to identify what the sector is not about: making profits for investors. The term 'non-

profit' is widely used in the USA. However, to some extent it carries the inaccurate implication that organisations are aiming only to break even, whereas they are in fact aiming to make a surplus – in order to reinvest this into a social purpose. The phrase 'not-for-profit', which captures the fact that such organisations are not working just for the purpose of making a profit, but rather to make a profit as a means to an end, addresses this concern.

2.6 The other approach is to say what the sector is about: pursuing community or social purposes. The term 'social economy' is reasonably well understood, being used commonly in international contexts, and particularly in Europe. An alternative is 'civil society'.

2.7 Finding a brand name for the sector is important, but it is not something which it would be appropriate for Government to do. Purely for the purposes of this report, the expression 'charitable and wider not-for-profit sector' is used.

2.8 'Social enterprise' is a term which cuts across the distinctions of legal status and legal form explained later in this chapter. The term is used to describe organisations which trade for a social purpose and which are largely self-financing. Many charities would class themselves as social enterprises on the basis that they generate their own income and rely on little or no grant aid. Most are becoming increasingly entrepreneurial in response to funding pressures and many have developed trading ventures.

## Overview of the sector

2.9 \* The paper ***The Organisational and Institutional Landscape of the UK wider Non-profit Sector*** sets out further details about the scale and diversity of the sector.

<sup>1</sup> NVCO (2000) Coming apart—or coming together? New findings on social participation and trust in Britain. Research Quarterly 11, December.



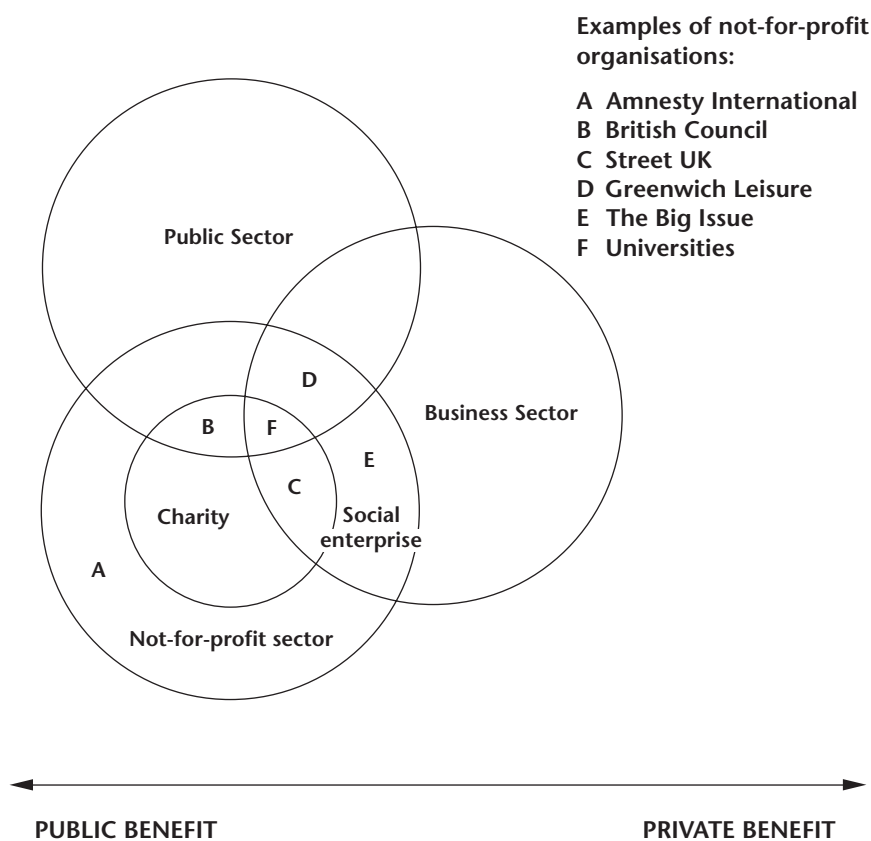


2.10 It is estimated that there are between 500,000 and 700,000 organisations in the charitable and wider not-for-profit sector in the UK. This diverse sector encompasses organisations of widely varying scale, purposes and structure. It includes large brand name charities, like Oxfam or Barnardo's, which employ thousands of people, and community-based groups with no paid staff.

2.11 Organisations in the sector pursue a broad range of purposes including health and social welfare, sport and recreation, environmental protection and the arts. Some provide services, others make grants, and some do both. Some deliver services to the public, others are based on a mutual model where benefits are restricted to members.

2.12 For the purposes of this report, the sector is defined broadly to include charities, self-help groups, community groups, social enterprises (organisations which trade for a social purpose, rather than for profit), and community-based mutual organisations with social objectives. It does not, however, attempt to cover large-scale mutual organisations such as building societies. It is therefore a sector dedicated to community benefit or social purposes equating approximately to what, in Europe, is termed the 'social economy', or what in the USA is called the 'non-profit sector'.

2.13 The following shows a stylised diagram<sup>2</sup> of the sector:



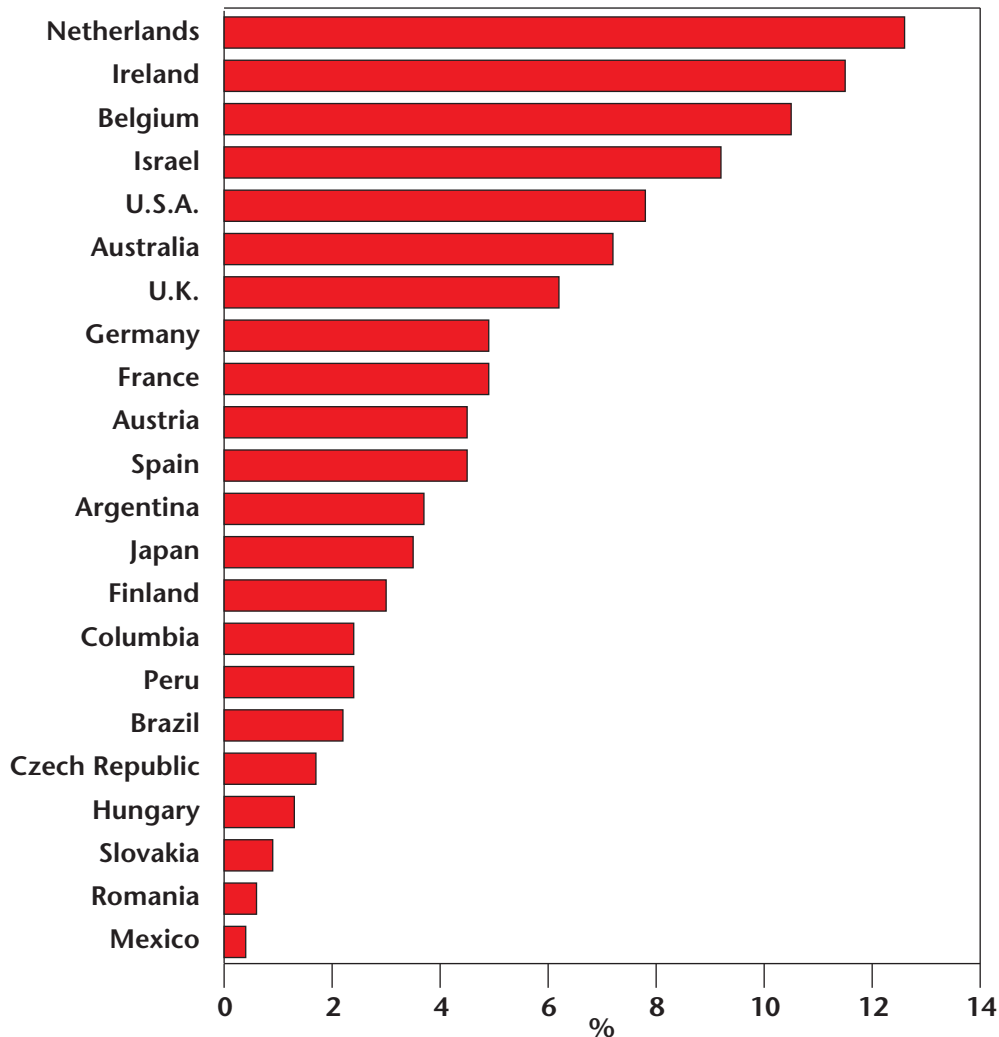
<sup>2</sup> Adapted from a model developed by University College London and the New Economics Foundation.



2.14 The overlapping circles show how different parts of the sector intersect. There is evidence that the boundaries are blurring, with many organisations working across or between traditional boundaries. For example, many not-for-profit organisations, some charitable, are increasingly using trading as a way to create sustainable sources of funds. Social enterprises, using entrepreneurial techniques for a social objective, like Street UK, a micro-credit organisation, are springing up. And some traditional businesses have well-developed corporate social responsibility programmes which deliver public benefit too.

2.15 Different administrative and legal frameworks, and the varied quality of the available data, complicate the comparison of charities and the wider not-for-profit sectors across countries. However, a broad indication is given by comparing the share of total non-agricultural paid employment contributed by the “non-profit sector”, defined broadly to comprise all voluntary, independent, non-profit-distributing institutions, as shown in figure 2.1 (1995 data<sup>3</sup>).

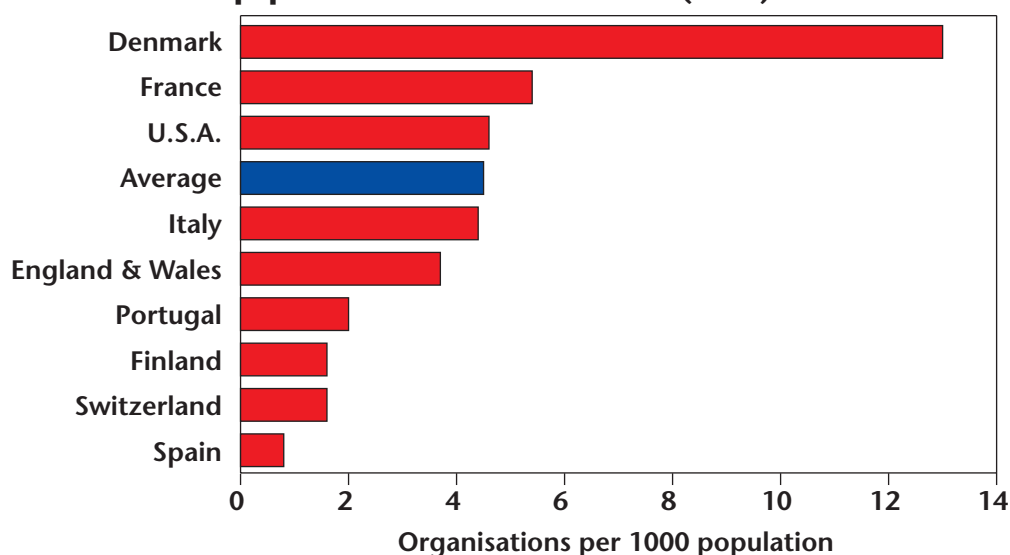
**Figure 2.1 International comparisons: share of total paid non-agricultural employment (%) by the non-profit sector**



<sup>3</sup> Source: L.M. Salamon et al (1999) Global Civil Society: Dimensions of the Nonprofit Sector. John Hopkins Center for Civil Society Studies.



**Figure 2.2 Not-for-profit organisations per 1000 population in selected countries (1998)**



2.16 The mean share of employment for the 22 countries in 1995 was 4.8%, approximating the values for Germany and France (4.9%), compared with an estimated 6.2% for the UK.

2.17 However, the number of not-for-profit organisations in England and Wales is perhaps slightly below average (figure 2.2)<sup>4</sup>.

2.18 This cross-sectional view of the sector masks significant changes over the past decade. In the UK during the 1990s, structural changes in higher education made polytechnics independent of local authorities; and registered social landlords (RSLs, i.e. housing associations registered with the Housing Corporation)

expanded by taking on council housing stock. These factors substantially increased the size of parts of the charitable and wider not-for-profit sector through a mix of government contracts and grants as well as private finance; and RSLs now account for 54% of the central government funding of voluntary and community organisations<sup>5</sup>. If RSLs and unregistered housing associations become the “hubs” of satellite bodies delivering a wide range of services under contract or through other relationships, they may in time become Social Investment Agencies<sup>6</sup> and introduce still greater diversity and dynamism into the sector.

<sup>4</sup> Data were compiled from EUROSTAT (2001) A pilot study on co-operatives, mutuals, associations and foundations; the Charity Commission’s Register; Registrar of Friendly Societies (2001) Report of the Chief Registrar 1999-2000; L. Salamon (1999) Scope and Structure: The Anatomy of America’s Non-profit Sector. Population statistics were derived from the World Bank demographic database. The data for European countries exclude “mutual” financial services organisations.

<sup>5</sup> Total government funding to the sector was £2.24 billion in 1999/2000, about 0.7% of total spending. Home Office (2001) Central government funding of voluntary and community organisations 1982/83 to 1999/2000.

<sup>6</sup> Housing Corporation and National Audit Commission (2001) Group Dynamics.



## Charities

### Registered charities

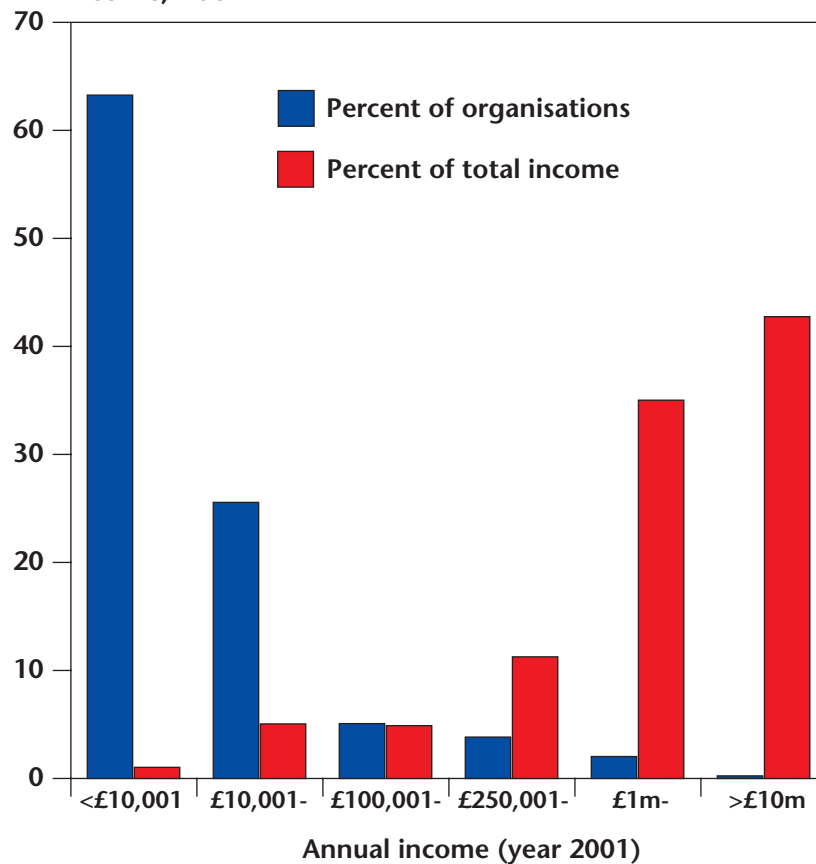
2.19 There are 188,000 registered charities in England and Wales (27,000 of which are branches or subsidiaries of other charities). Their numbers have been growing by about 1,800 per year since 1990.

2.20 Most registered charities are relatively small (see figure 2.3)<sup>7</sup>. In 2001, the 372 large charities whose annual income exceeded £10 million received more than one-third of the £26.71 billion total income of registered charities. There were 42,012 registered charities

with an income of £1,000 or below, and 59,699 with an income between £1,001 and £10,000.

2.21 Polls suggest that many people think there are too many small charities. However, there is great value in encouraging new charitable endeavours. Small local charities are a vehicle for community involvement; they contribute to diversity; they develop new approaches to local problems; and they identify new needs quickly. As with business, there is merit in competition and diversity. The steady creation of new charities is a good thing. Some will emulate the more successful small organisations and others will eventually develop into large national bodies.

**Figure 2.3 Distribution of registered charities by annual income, 2001**



<sup>7</sup> Data on the 160,778 main charities (excluding subsidiaries) from the Charity Commission. <http://www.charitycommission.gov.uk/registeredcharities/factfigures.asp>



2.22 Statistics for the sector differentiate registered charities from a sub-set used by the Office for National Statistics and termed “general charities”<sup>8</sup>. The more restrictive definition of general charities, which comprise the household-name national charities as well as a vast number of local charities, number 141,000 and alone have a total annual income of £15.6 billion (2001 figures). They benefit from the contributions of just over 3 million volunteers representing the equivalent of 1.5 million full time equivalent jobs<sup>9</sup>. Some 750,000 people act as their trustees<sup>10</sup>. It is estimated that the total value of unpaid work in general charities in 2000 was over £15 billion.

2.23 The sector also has economic weight. It is an increasingly significant employer: full-time equivalent jobs (FTEs) increased by 6.7% between 1998 and 2000, more than in either private or public sectors. General charities now employ over half a million workers, representing the equivalent of 451,000 full time equivalent jobs or 2.2% of the total UK workforce<sup>11</sup>. This compares with about 2.3% of the workforce employed by co-operatives, foundations and associations elsewhere in Europe<sup>12</sup>.

### *Unregistered charities*

2.24 There are also a large number of charities which are not registered. For example, very small organisations with income of £1,000 or less, along with certain classes of charity including churches of particular denominations, do not have to register – these are collectively called “excepted” charities. Other types of

charities, including universities, housing associations and some schools, are not registered on the grounds that they are regulated by other agencies. These are termed “exempt” charities.

### *Sources of charity income*

2.25 Some charities receive significant income from government in the form of grants or fees for services provided, making up nearly one-third of their total income<sup>13</sup>. They also receive tax and business rates reliefs. The rates relief extends more broadly to philanthropic and benevolent organisations. Among charitable organisations receiving substantial Government funds are RSLs funded through the Housing Corporation. Between 1996 and 2000, annual capital and revenue grants to RSLs averaged £1.17 billion, or 25% of the sector’s total turnover of £4.67 billion<sup>14</sup>.

2.26 Higher education institutions receive funding from the Funding Councils. In 1999-2000, 40% of UK universities’ total £12.8 billion income derived from Funding Council grants; project-specific research grants and contracts with the Research Councils and with Government Departments also contribute significantly.

2.27 The NCVO’s income matrix, applied to successive rounds of survey data, provides the main current source of systematic evidence for the scale and dynamics of the sector in the UK (see Box 2.1). This allows analysis along a variety of dimensions for data collected at intervals since 1991.

<sup>8</sup> The “general charities” exclude non-departmental public bodies and quasi non-governmental organisations (e.g. British Council, British Museum); and financial institutions allocated to the corporate sector in national accounts. Approximately 40% of registered charities with annual incomes exceeding £10 million are excluded by these criteria.

<sup>9</sup> NCVO (1998) Survey of Job Roles and Salaries.

<sup>10</sup> NCVO (2001) Recent trends in charity governance and trusteeship.

<sup>11</sup> NCVO (2002) The UK Voluntary Sector Almanac, 2002.

<sup>12</sup> Calculated from EUROSTAT pilot data for 1998 on Denmark, Spain, France, Portugal, Finland, Sweden and Switzerland reported in “A pilot study on co-operatives, mutuals, associations and foundations” (2001).

<sup>13</sup> NCVO (2002) The UK Voluntary Sector Almanac, 2002.

<sup>14</sup> Figures supplied by the Department for Transport, Local Government and the Regions.



| <b>Box 2.1 NCVO's Income matrix</b> |                         | <b>Transaction type</b>  |  |   |
|-------------------------------------|-------------------------|--|--|---|
| <b>Sources of income</b>            |                         | Earned income  | Voluntary income   | Return on investments   |
|                                     | General public          | Fees for goods and services; membership subscriptions with significant benefits. | Street and door-to-door collections; gift aid payments; legacies; membership subscriptions with no significant benefits. |   |
|                                     | Government              | Local authority community care contracts.  | Grants for core funding and project activities from central government and the E.U.                                      |   |
|                                     | Voluntary organisations | Services provided under contract.  | Grants from charitable trusts.   |   |
|                                     | Business                | Sponsorship; research services; patent royalties.                                | Grants from businesses' community affairs departments.   |   |
|                                     | Internally generated    |  | Donated profits from trading subsidiaries.   | Equities; UK government securities; common investment funds; realised gains |

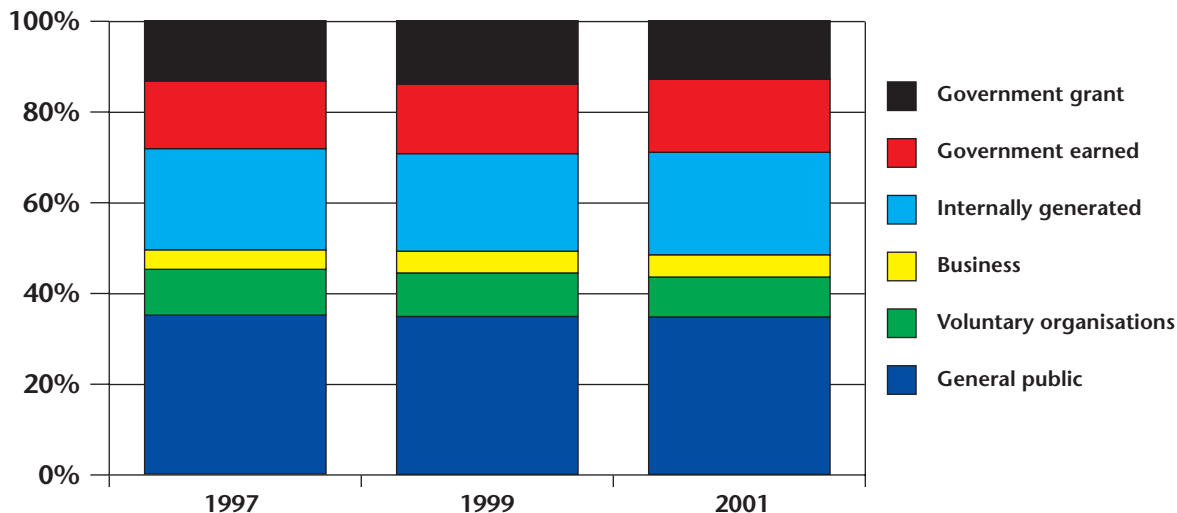
2.28 Using the data on sources of income, and differentiating between government grant and contract income, figure 2.4 shows that the

distribution of funding sources to general charities as a whole has remained broadly stable over the past five years<sup>15</sup>.

<sup>15</sup> Data compiled from the NCVO UK Voluntary Sector Almanacs for 1998/99, 2000, and 2002.



**Figure 2.4 Income to general charities by source 1997-2001**

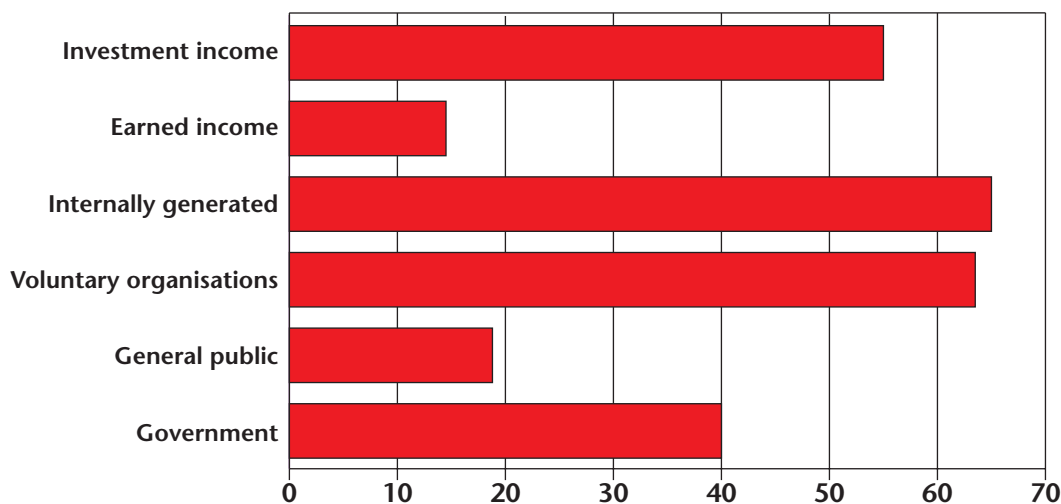


**Trends in charity income**

2.29 There have been substantial increases in income to charities over the past decade. Gross income of UK general charities increased by 31.7% or £3.7 billion in real terms during 1991-2001. Increases in income from investments, internal activities, other voluntary

organisations, and government sources, were substantial, but growth in income from earnings and the public has tended to lag behind (figure 2.5)<sup>16</sup>. However, income growth was not constant. Average annual income grew by 4% per year in the five years to 1995, and 2.3% per year from 1995 to 2001.

**Figure 2.5 general charities: % change in income by source 1991-2001**



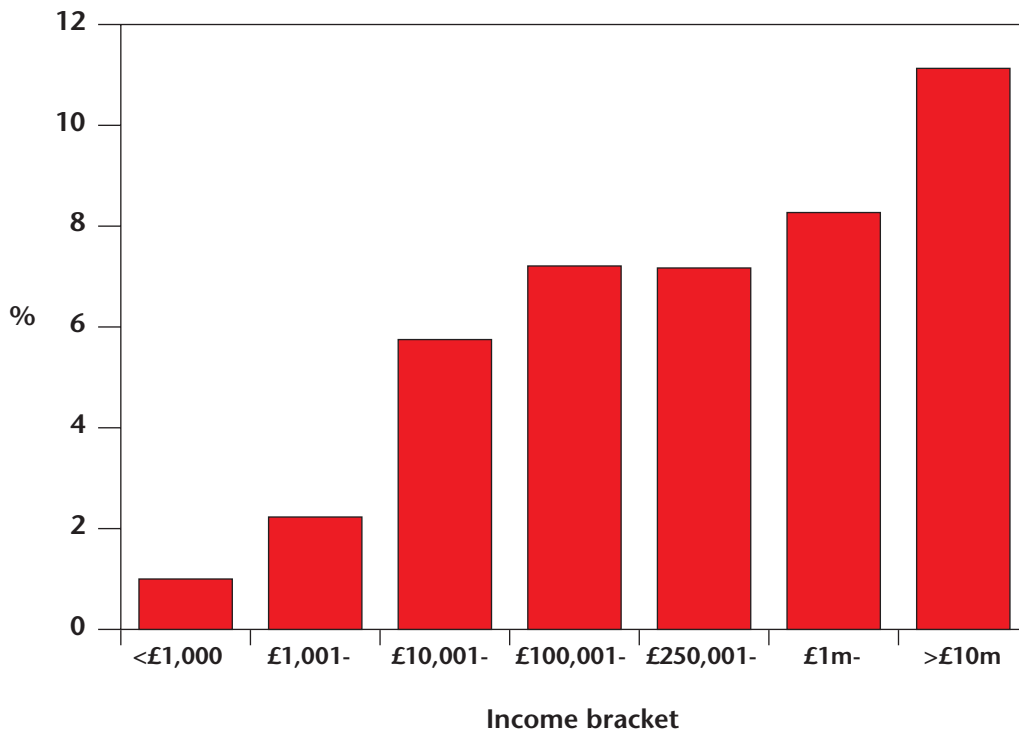
<sup>16</sup> Data from NCVO (2002) The UK Voluntary Sector Almanac, 2002.



2.30 In the latter period, the relative contribution by the general public fell by 1.3%, reflecting declines in both the percentage of the population giving to charity (from 70% to 65%), and the average amount given (from £11 to £9 monthly); but these declines have now largely been reversed<sup>17</sup>. On the other hand, relative contributions by Government rose by 1.1%. The period 1995-2001 may, therefore, have seen only a temporary dip in the growth rate of income, as the latest figures show that income growth has been increasing again over the past two years<sup>18</sup>.

2.31 However, the sector is diverse and patterns of income growth, and the drivers for these changes, differ with the size of organisation. Figure 2.6 shows that since 1998, there have been substantial increases in the volume of the income of registered charities within each income bracket, except the smallest<sup>19</sup>. These increases are strongly related to income bracket and suggest that significant benefits are conferred by size, perhaps as a result of brand strength, efficiency, or economies of scale.

**Figure 2.6 Annual percent change in income of registered charities averaged over 1998-2001**



<sup>17</sup> NCVO (2002) The UK Voluntary Sector Almanac 2002.

<sup>18</sup> Total income of general charities increased by 2.1% in 1999-2001 compared with 1.7% in 1997-99, and 2.8% in 1995-97.

<sup>19</sup> Calculated from annual statistics provided by the Charity Commission web-site, adjusted to 1998 income by the change in retail price index.



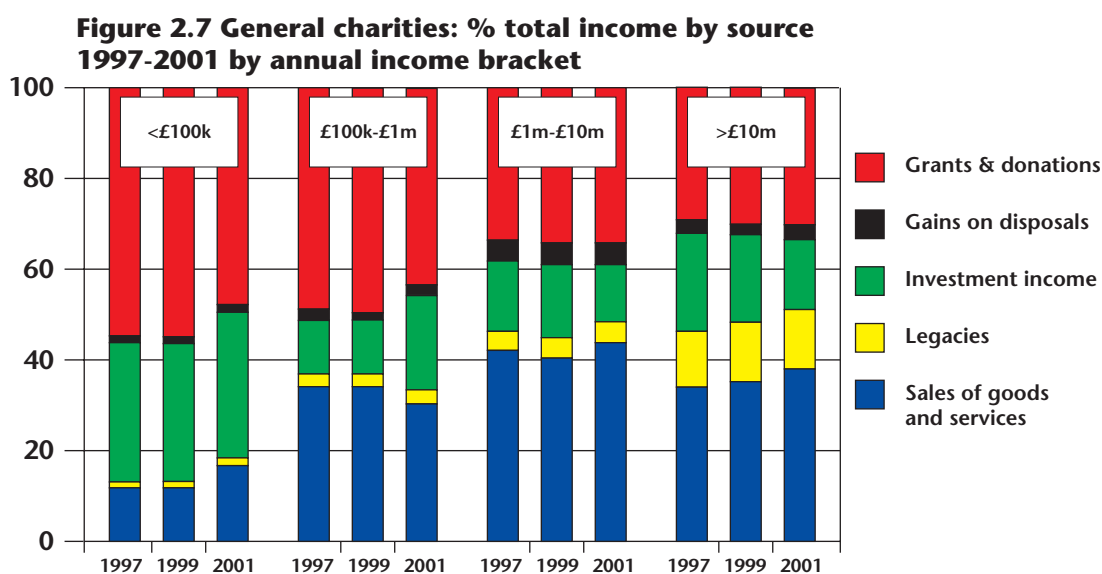


2.32 This impression is reinforced by analysis of income streams over the past decade, which highlights a number of differences between income brackets<sup>20</sup>.

- For charities with less than £100,000 annual income, the major impetus to income growth has been investment income. Funds from earnings, grants and donations grew less well during the decade.
- Those charities with annual income of £100,000-£1m showed strong growth in voluntary income between 1991 and 1995, followed by a declining contribution, while investment income grew well for much of the decade and especially since 1999.

- Charities with an income of £1m-£10m showed a declining contribution of earned income over the period 1991-1999, picking up thereafter.
- The largest charities (income greater than £10m) showed generally strong growth in all sources, but especially in fee income and sales of goods and services.

2.33 Figure 2.7 shows the trends for the last five years only<sup>21</sup>. These suggest that larger charities depend more on earnings and legacies, smaller ones more on investments, grants and donations.



<sup>20</sup> NCVO (2002) The UK Voluntary Sector Almanac 2002.

<sup>21</sup> Data sources as for figure 2.4.

## The non-charitable not-for-profit sector

2.34 There are an enormous variety of organisations which do not have charitable status, but which fall into a large but under-recognised “middle ground” which is neither charity nor business. The common thread between them is that they operate primarily for a social purpose. The vast majority also choose on principle not to distribute profits to investors. They include:

- small, community-based groups;
- organisations working for their members;
- some employee-owned businesses; and
- other types of businesses which operate for a social purpose rather than to make a profit.

2.35 It has been estimated<sup>22</sup> that there are approximately 180,000 – 360,000 community level organisations in the UK, such as hobby clubs, community shops and youth groups, typically having small levels of income and assets, but high participation and membership. Such organisations can be extremely important in building trust and cohesion in communities, and in developing the skills of those involved in running them. Government can help them by ensuring that the legal and regulatory system does not stifle small-scale activity.

2.36 Mutual organisations, like credit unions and co-operatives, have a long history of bringing people together for common goals. At the community level, they can be a very effective way of tackling social deprivation and giving local people responsibility. On a larger scale, UK agricultural co-operatives have over a

quarter of a million members. Co-operatives and mutuals also form an important part of the retail and financial services sectors.

2.37 There is also a wide range of other innovative organisations which trade for a social purpose, from Fairtrade food producers, to recycling organisations, to the Big Issue. Changes in the number of such organisations are difficult to track, but the sector appears to be expanding; the most recent estimates suggest that social enterprises grew by 9% in 2000 and now involve nearly 5.5 million people<sup>23</sup>.

## Corporate social responsibility

2.38 Not all socially beneficial activity is undertaken by charities and the wider not-for-profit sector or by Government. Corporate social responsibility can be a powerful force for change; and initiatives like Business in the Community have fostered a growing realisation amongst companies that there is not just a moral argument, but also a powerful business case, for taking ethical issues seriously.

2.39 The level of commitment, though, varies widely. Some companies regard their social activities as an integral part of their business philosophy. However, many do not and good practice is still patchy. Although there is little robust evidence on expenditure on corporate social responsibility, overall levels of giving by companies to charities remain relatively low at around 0.2% of pre-tax profits compared with around 1% in the USA.

<sup>22</sup> Estimate derived from the report by the National Strategy for Neighbourhood Renewal’s Policy Action Team 9 (1999) Community Self-Help.

<sup>23</sup> Estimate provided by the New Economics Foundation, and cited in Social Enterprise London (2001) Social Enterprise, Social Economy: Moving Ahead (conference report); the figure is based only on data for networked organisations like community development trusts and co-operatives.



## Legal forms taken by charities and other not-for-profit organisations

2.40 Many small charities and other not-for-profit organisations are loose groupings of individuals who have come together to meet a local need or for mutual benefit, and are unincorporated bodies. As they grow and develop, and seek to obtain credit or enter into contracts, many find it necessary to incorporate or adopt a legal form.

2.41 There are no legal forms which were designed for charities. Organisations face the same choices about incorporation whether or not they are charities. Charitability is a status, not a legal form – an official badge which may be attached to a range of different types of organisation.

2.42 A limited number of options is open to voluntary organisations wishing to incorporate:

### *Company limited by guarantee*

2.43 The company limited by guarantee (CLG) is a legal form used by charities and other not-for-profit organisations in which members nominally own the 'company' but have no right to a share in any surplus made. There is a wide range of possible membership structures. Membership may consist only of members of the board; at the other extreme, all the users of the services provided may be eligible to be

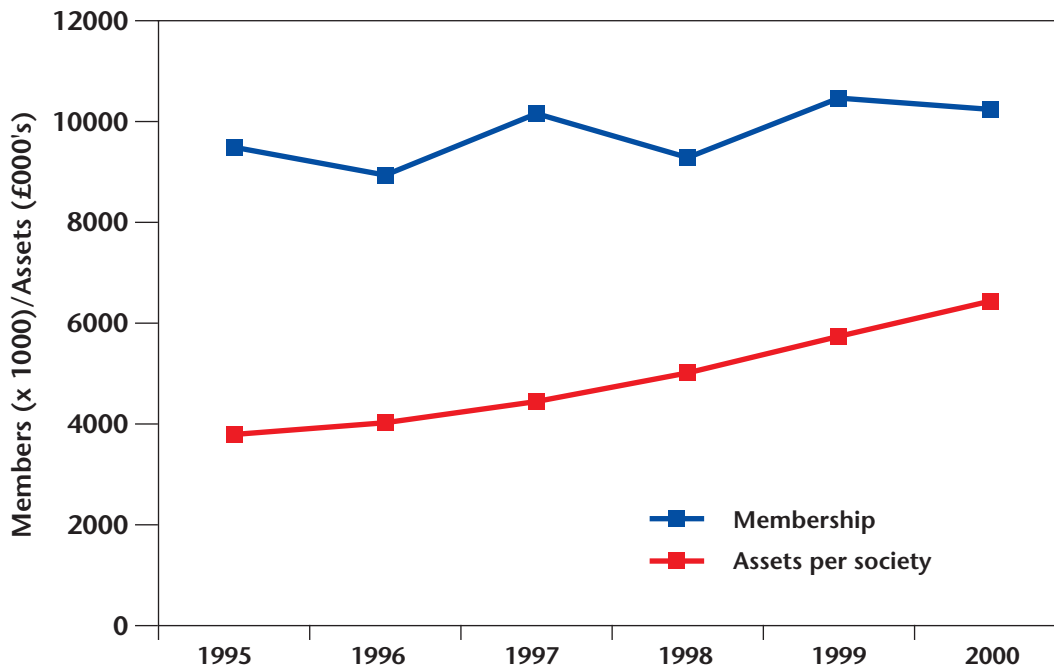
members. The CLG has proven a popular form. Rates of registration of CLGs have more than doubled during the past decade. Over 5,000 now register per year, with just under half of these being organisations which have dropped the "Limited" from their name under section 30 of the Companies Act, and are therefore most likely to be charitable<sup>24</sup>.

### *Industrial & Provident Society*

2.44 Alternatively, an organisation may choose to incorporate as an Industrial and Provident Society, a form closely associated with the co-operative movement. There are two variants:

- *Bona fide* co-operatives ("Co-ops") operate for the mutual benefit of their members, with any surplus being ploughed back into the organisation to improve services, or distributed as dividends to members. Since co-ops usually work only for the mutual benefit of their members, they cannot be charitable.
- Benefit of the community societies ("BenComs") are organisations primarily engaged in trade for a social purpose and which have special reasons for not incorporating as companies. Whilst they have membership structures, they operate for the benefit of the wider community. A BenCom with an appropriate purpose can be charitable.

<sup>24</sup> Data from analysis by University College London's Institute for Philanthropy

**Figure 2.8 Trends in Industrial & Provident Societies 1995-2000**

2.45 The number of societies has averaged about 9,360 over the period 1995-2000 and been falling by about 3% per year, but figure 2.8 shows a slight upward trend in numbers of members. Total assets per society have also increased significantly over this period, a result mainly of growth in housing associations and general services<sup>25</sup>.

### The current system of regulation

2.46 Charities and other not-for-profit organisations may be regulated for a number of reasons. Some are analogous to the reasons for regulating the business sector – to ensure that sufficient information is provided to stakeholders, that accounts are kept, that governance is conducted properly, that the

interests of certain stakeholders are considered, and that fraud is prevented. Others are specific to the sector. Regulation may seek to protect the public interest, to protect donors, and to promote public confidence.

2.47 Generally speaking, registered charities face a heavier burden of regulation than non-charitable not-for-profit organisations. This is due to the fact that they commonly receive tax advantages and public donations. A check is also needed that trustees are using the income and assets of the charity in pursuit of the charity's objectives.

2.48 In the non-charitable sector, the level of regulation tends to vary by activity. Housing associations, for instance, are relatively heavily regulated, regardless of whether or not they are charities.

<sup>25</sup> Calculated from data on Co-ops and BenComs combined in Registrar of Friendly Societies (2001) Report of the Chief Registrar 1999-2000. Asset figures have been adjusted to 1995 values by the change in the retail price index. Figures for 2000 were supplied by the Registrar.



2.49 There is no single regulator for charities and the wider not-for-profit sector. Instead, organisations face regulation on four levels.

- Regulation by legal status: for the sector, this often means charitable status and regulation by the Charity Commission.
- Regulation by legal form: registration for Companies and Industrial and Provident Societies.
- Regulation by activity or function: for Registered Social Landlords by the Housing Corporation, for Higher Education Institutions by the Funding Councils.
- Self-regulation: for organisations which fall below the threshold requiring registration as charities, or which are otherwise excepted from regulation.

2.50 The nature and impact of existing forms of regulation, and proposals for their reform, are considered in Chapter 7.

### 3. DEVELOPING THE SECTOR'S POTENTIAL

#### Summary

- Although charities and the wider not-for-profit sector make an important contribution to national life, there are barriers to their achieving their full potential. Reform of the legal and regulatory framework would help tackle many of these.
- The review is based on the following principles and goals:
  - Freedom of association
  - Respect for the sector's independence
  - Promoting public confidence
  - Supporting the delivery of public benefit
  - Promoting public accountability and transparency
  - A proportionate, risk-based approach to regulation
  - Simplifying and harmonising regulation where possible
  - Clear, consistent and transparent regulation
  - A fair, effective and accountable system.
- Government's overall strategy towards the sector should have four main strands:
  - Helping not-for-profit organisations play a bigger role in revitalising communities and empowering citizens
  - Encouraging public support for the sector
  - Helping the sector become more effective and efficient
  - Enabling the sector to become a more active partner with Government in shaping policy and delivery



This chapter considers:

- the sector's contribution to national life;
- those barriers to the sector achieving its full potential which can be tackled by legal and regulatory reform;
- the principles and goals underpinning the review; and
- Government's role and strategy towards the sector.

## The sector makes an important contribution to national life

3.1 Charities and the wider not-for-profit sector make an important and growing contribution by:

- providing vital services;
- strengthening communities;
- identifying new needs;
- representing important interests that otherwise risk being marginalised;
- contributing to public goods like the environment; and
- innovating new ways of tackling social problems.

3.2 The Government values this contribution, and has already taken a number of measures to support the sector, for instance through improved tax reliefs on giving.

## There are still barriers to the sector achieving its full potential

3.3 More remains to be done to provide an environment which is conducive to the sector's growth. There are a number of barriers to the

sector developing its full potential, many of which can be tackled by changes to the legal and regulatory framework. Each barrier, together with the Government's proposals for reform, is discussed in greater depth in Chapters 4 to 7, as follows:

- The current approach to determining charitable status does not always ensure that benefits attach to objectives that society sees as having public benefit (Chapter 4).
- Restrictions on trading and investment inhibit charities' entrepreneurial activity, and restrictions on campaigning limit the charities' advocacy role (Chapter 4).
- There are barriers for charities that wish to merge (Chapter 4).
- There is an incomplete menu of organisational forms for the full range of activity undertaken by charities and the wider not-for-profit sector, and some legal forms are in need of updating (Chapter 5).
- There is not enough accessible, relevant and comparative information about charities and other not-for-profit organisations. Greater transparency and accountability, as well as greater public understanding of the sector are needed (Chapter 6).
- Some organisations in the sector lack the necessary incentives and support to measure and improve their performance (Chapter 6).
- The lack of an adequate mechanism for updating charitable status makes it harder for the law to keep pace with economic and social developments (Chapters 4 and 7).
- The lack of an inexpensive and accessible appeals mechanism for the Charity Commission's legal decisions means that the only recourse organisations currently have is to the courts, which can be beyond their means (Chapter 7).

- Regulation is too onerous for small organisations and those at the start of their lifecycle (Chapter 7) but is ineffective in other areas such as fundraising (Chapter 6).

## The review should be based on the following principles and goals

3.4 The following principles should underpin reform of the legal and regulatory framework.

### *Freedom of association*

3.5 In a democratic society, individuals should be as free as possible to join together in pursuit of lawful purposes with minimal interference from the state. In practical terms, this means that care should be taken to avoid introducing measures which increase bureaucracy and discourage people from forming associations. Many small community groups have no wish to grow bigger. A good proportion are undetectable by the 'radar' of regulators and other state bodies. That is how it should be.

### *Respect for the sector's independence*

3.6 Charities and other not-for-profit organisations are independently governed. This enables them to respond directly to the needs of a particular local community or interest group. They can choose to work with Government or not, and to advocate changes in policy. Many skilfully manage both. Changes to the framework should respect and safeguard this independence.

### *Promoting public confidence*

3.7 Charity law gives donors confidence that their money will be used for the purposes for which it was given. Charities in particular have a reputation for legitimacy partly because they are perceived to be regulated by the state. Promoting public confidence is an important objective because the sector's success ultimately depends on public support.

### *Supporting the delivery of public benefit*

3.8 Government support should be targeted at those organisations which deliver benefit, broadly defined, to the public. However, case-by-case decision-making about which organisations deliver public benefit should be independent of Government to ensure that public benefit is not defined according to political interests. Government should also support the delivery of increased public benefit by helping organisations delivering public benefit to become more effective and efficient.

### *Promoting public accountability and transparency*

3.9 Charities and not-for-profit organisations should be encouraged to be as open and accountable as possible to stakeholders. This will both promote public confidence and help them ensure that they are most effectively serving their chosen constituencies, however defined.

### *A proportionate, risk-based approach to regulation*

3.10 Regulation should have clear objectives. It should be carefully targeted and proportionate to risk – both to the risk of abuse and also to the risk of damage to public confidence. In general, this means that regulation of small organisations, where the sums of money involved are modest, should be lighter than regulation of large organisations, which handle large sums and may also have a disproportionate impact on public confidence.





*Simplify and harmonise regulation where possible*

3.11 Charities and other not-for-profit organisations are regulated in relation to their status, form and activities. Many also participate in self-regulatory initiatives. Some of the complexity in the system cannot be avoided. However, where possible, requirements should be simplified and harmonised.

*Clear, consistent and transparent regulation*

3.12 A lack of clarity and consistency in regulation makes it difficult for organisations to understand their obligations – and, therefore, to comply with them. A lack of clarity can also make organisations excessively wary of taking risks and an unduly conservative approach may reduce the amount of public benefit they are able to deliver.

*A fair, effective and accountable system*

3.13 The regulator must have the powers and capacity to deliver a fair and effective system of regulation. This means for example, ensuring accessible and fair complaints and appeals mechanisms.


**The Government's strategy should be to help realise the sector's potential, whilst respecting its independence**

3.14 The Government recognises that the independence of the sector is crucial – and the key to its continued success. Whilst some

charities and not-for-profit organisations wish to work with Government, delivering statutory services, receiving grant aid, or providing input into consultations, others do not. Charities and other not-for-profit organisations of all kinds should have the confidence to be truly independent and to have a dissenting voice, whilst still being supported, encouraged, and valued by Government.

3.15 The Government would like to see a modern, dynamic and diverse sector which continues its tradition of innovation, makes itself accountable and enables diverse communities to play a full role in society. The sector should not duck difficult issues like fundraising costs but have the courage to regulate itself, to explain its ethos, and to educate society about its role. There is a need for the sector to develop better financial sustainability over the long term, and to ensure that it is attractive to a new generation of socially aware individuals and is responsive to their needs and concerns.

3.16 One of the objectives of the review is to clarify the Government's strategy towards the sector. This is an opportunity to show how different initiatives fit together as part of a coherent overall approach which should be developed in partnership with the sector.



### ***Box 3.3: Government strategy towards charities and the wider not-for-profit sector***

The Government's strategy for the sector has four main strands.

*Helping charities and other not-for-profit organisations play a bigger role in revitalising communities and empowering citizens:*

- building social cohesion and inclusion by involving citizens;
- tackling social problems through enhanced local initiative and responsibility; and
- increasing economic activity and employability in local communities.

*Encouraging public support for the sector:*

- encouraging participation by promoting active citizenship and volunteering;
- encouraging financial support from individuals and businesses through tax-efficient giving; and
- promoting public confidence and accountability by creating an appropriate legal and regulatory framework.

*Helping the sector to become more effective and efficient:*

- strengthening the sector's national, regional and local infrastructure;
- ensuring that charities and other not-for-profit organisations have access to appropriate information, advice and support; and
- encouraging the public, private and not-for-profit sectors to share best practice.

*Enabling the sector to become a more active partner with Government in shaping policy and delivery:*

- promoting and developing the Compact, which sets out the principles by which the Government and the sector will work together;
- promoting effective involvement of the sector in policy development and delivery; and
- encouraging a flexible, streamlined and joined-up approach to funding the sector across government.

### ***The devolved administrations' strategies towards the sector***

3.17 Within this strategy, the Government recognises that the not-for-profit sector and volunteering are devolved issues, the policy

responsibility for which to varying degrees lies with administrations in Wales, Northern Ireland and Scotland. Their policies and practices reflect local conditions, traditions and priorities. The following sections, which use local terminology, illustrate the strategies being pursued.



### *Scotland*

3.18 The Scottish Executive recognises that the voluntary sector plays a crucial role in policy development, as a major service provider and in building communities. It is fully committed to assisting voluntary organisations and aims to modernise the sector's legal and financial frameworks and to develop its infrastructure to enable the social economy in Scotland to realise its full potential. To this end it is:

- reviewing implementation of the Scottish Compact since its introduction in October 1998;
- increasing its direct and indirect funding of the sector (which is now at some £343m in total) in addition to improving its own funding practice with a view to simplifying, standardising and reducing bureaucracy;
- conducting a review to assess the social economy's potential to contribute to Scottish Executive objectives;
- sponsoring a range of voluntary sector infrastructure organisations and promoting IT in the sector by supporting the development of a voluntary sector portal for Scotland, which will serve as a single gateway to the sector for not-for-profit organisations, their members, supporters and the public;
- taking forward the Active Communities Initiative, with the aim of fostering a more positive attitude to community involvement and increasing the number of volunteers, especially those from excluded backgrounds;
- setting up an Advisory Forum comprising representatives from the sector and key agencies to contribute to the analysis and implementation of the recommendations of the Scottish Charity Law Review (the McFadden report);
- conducting a strategic review of funding for the voluntary sector, which will look not just at the Scottish Executive's own funding, but at the funding provided by other public funders such as Agencies, Non-Departmental Public Bodies and local government; and
- conducting a strategic review of funding for the minority ethnic voluntary sector with a view to improving the way the Scottish Executive supports this sector.

### *Wales*

3.19 The Welsh Assembly Government is committed to a strong partnership with the three key sectors of society in Wales: business, local government and the voluntary sector. It has demonstrated its commitment to forging strong links with the voluntary sector by endorsing the "Compact". However, the Government of Wales Act 1998 required the Assembly to "... make a scheme setting out how it proposes, in the exercise of its functions, to promote the interests of relevant voluntary organisations".

3.20 This Voluntary Sector Scheme, which is unique to Wales, was endorsed on 5th July 2000, and established the Voluntary Sector Partnership Council, a body composed of representatives of the voluntary sector and members of the Assembly. The work of the Partnership Council to date includes a strategic review of funding the Voluntary Sector in Wales, a Code of Practice for Funding the Voluntary Sector, and the Voluntary Sector Scheme Action Plan, which maps out the joint working needed to achieve the aims of the Scheme.



3.21 In recognition of the increased workload resulting from the challenges of increased partnership working, the Welsh Assembly Government has taken three main steps to build the capacity of the not-for-profit voluntary sector in Wales:

- strengthening the capacity of County Voluntary Councils by increasing funds available to the Councils through the Local Voluntary Services Scheme;
- increasing the core grant to the Wales Council for Voluntary Action; and
- acknowledging the time and commitment given by member organisations of the Voluntary Sector Partnership Council by establishing the Partnership Capacity Building Fund.

Further information on the Voluntary Sector Scheme can be found on the National Assembly for Wales website:

[www.wales.gov.uk/themesvoluntarysector](http://www.wales.gov.uk/themesvoluntarysector)

#### *Northern Ireland*

3.22 The Government in Northern Ireland values the significant contribution that the voluntary and community sector makes to the social, economic, environmental and cultural life of Northern Ireland. In recognition of the importance of working in partnership with the sector, it developed "Partners for Change: Government's Strategy for Support of the Voluntary and Community Sector 2001 – 2004". ([www.dsdni.gov.uk/publications](http://www.dsdni.gov.uk/publications)). Consultation on this document ended on 31st October 2001 and the final document will be published by October 2002.

3.23 The Strategy, which covers the devolved and non-devolved administrations for Northern Ireland, has four key aims: Shaping Policy Development; Building Communities; Promoting Active Citizenship and Tackling Disadvantage. To achieve these, each Department commits to a number of action points under three key cross-cutting themes:

- Capacity Building – strengthening the ability of people to be involved and take responsibility in and for their own community. The development of the skills, competences, tools, processes and resources that are needed to enable the Departments and the sector to achieve positive and sustainable outcomes.
- Working Together – ensuring the sector is actively involved in developing, implementing and monitoring policy. Sharing knowledge, experience and best practice. Working together to deliver services.
- Resourcing the Sector – providing direct financial support, specialist advice and information and providing help in kind to the sector.

3.24 Over 150 practical actions are identified, ranging from a commitment to review the advisory and consultative forums to ensure appropriate representation of not-for-profit organisations, to conducting a review of the scope to develop the social economy by July 2001, to inform funding under the European Programme, Peace II.

## **4. REFORMING THE LEGAL FRAMEWORK: A MODERN APPROACH TO CHARITIES FOCUSING ON PUBLIC BENEFIT**

### **Summary**

- The law on charitable status is based on the 1601 Statute of Elizabeth and decided cases. Charitable purposes are characterised as relief of poverty, advancement of education, advancement of religion and other purposes beneficial to the community.
- The current law is confusing and unclear and the four categories or heads of charity do not accurately reflect the range of organisations which are, or should be, charitable today.
- A new definition comprising ten purposes of charity sets out a clearer framework while retaining existing case law and the flexibility to evolve as society changes.
- Advancement of amateur sport, the promotion of human rights, conflict resolution and reconciliation and the prevention of poverty will become explicitly charitable for the first time.
- In the future all charities will have to demonstrate public benefit. Currently some purposes are presumed to be for the public benefit.
- The Charity Commission will undertake an on-going review to check the public character of charities which charge fees that tend to exclude large sections of the public.
- Currently charities are only permitted to undertake substantial trading that is directly connected to their charitable purpose, with all other trading done through a subsidiary. Allowing charities, subject to a specific statutory duty of care, to undertake all trading within the charity would remove much of the burdensome complexity in the current system.
- Charities perform a valuable role in campaigning for social change. The Charity Commission should revise its guidelines on campaigning to distinguish between legal requirements, which are very general, and more detailed good practice advice.



- **There is sometimes real benefit in charities working together or even, on occasion, merging. When trustees believe it to be in the best interest of a charity, the legal and regulatory framework should facilitate mergers.**

\* A more detailed paper **Charitable Status** on the Website gives more detail on these recommendations.

This chapter considers:

- the current definition of charitable status;
- difficulties arising from the definition;
- the objectives of reform;
- a new definition of charitable status focusing on public benefit; and
- other legal changes to enable charities to be more entrepreneurial, campaign effectively and evolve as circumstances change.

## The current definition of charitable status

4.1 To be charitable an organisation must fulfil two conditions: it must have purposes that are recognised as exclusively charitable, and be established for public benefit.

## Charitable purposes

4.2 Charitable purposes are based on an illustrative list in the preamble to the 1601 Statute of Elizabeth (see Box 4.1). This was intended to correct abuses and to give examples of what was charitable at the time. Over the centuries, this has been developed by the courts to add new purposes based on an interpretation of the preamble.

4.3 In the nineteenth century, the courts updated the interpretation of the Statute by characterising charitable purposes as falling into four categories or “heads”<sup>26</sup>:

- 1 Relief of poverty** (or more specifically the aged, impotent or poor).
- 2 Advancement of education.**
- 3 Advancement of religion.**
- 4 Other purposes beneficial to the community**, not falling under any of the preceding three heads.

This set a precedent that has been followed to this day.

### Box 4.1: Extract from preamble to the Charitable Uses Act 1601 (known as the Statute of Elizabeth I)

“The relief of aged, impotent, and poor people; the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars of universities; the repair of bridges, havens, causeways, churches, sea banks and highways; the education and preferment of orphans; the relief, stock or maintenance of houses of correction; marriages of poor maids; supportation, aid and help of young tradesmen, handicraftsmen and persons decayed; the relief or redemption of prisoners or captives and the aid or ease of any poor inhabitants...”

<sup>26</sup> *Income Tax Special Purposes Commissioners v Pemsel* [1891] A.C. 531, 583.



## Scotland and Northern Ireland

4.4 As supervision and regulation of charities is devolved to the Scottish Executive and to the Northern Ireland Assembly, for purposes other than tax the definition of charity is a devolved responsibility. However, tax is a reserved matter and the definition of charity in this chapter will be relevant for organisations claiming tax relief throughout in the UK.

## Public benefit

4.5 The balance of public and private benefit can be difficult to judge. Public benefit will often involve individual private benefit as well – for example, in the field of education, the educated individual benefits from improved job opportunities, while society benefits from a better educated population. Even a private business, which distributes profits to shareholders, may have the positive social effect of providing jobs. In these examples the former is charitable and the latter is not, but inevitably there will be cases where it is not so straightforward.

4.6 It is commonly understood that public benefit is presumed to be present for organisations involved in the relief of poverty, the advancement of education or the advancement of religion unless there is evidence to the contrary. And that for charities with objects that fall under ‘other purposes beneficial to the community’, public benefit must be demonstrated unless it is self-evident. But it is not the case that the presumption means that some charities are wholly exonerated from the public benefit requirement. All institutions must, in order to be charities, be demonstrably established for the public benefit. The presumption is of limited practical significance.

4.7 Public benefit is assessed on a case-by-case basis, examined on its own merits. Attempting to define public benefit is difficult, but the

Charity Commission guidance<sup>27</sup> is a useful place to start. This sets out a list of characteristics which are indicative of public benefit:

- The organisation benefits the public as a whole or a sufficient section of it.
- The beneficiaries are not defined in terms of a personal or contractual relationship.
- The beneficiaries should not be defined by an inappropriate or capricious link.
- Membership and benefits should be available to all those who fall within the class of beneficiaries.
- Any private benefit arises directly out of the pursuit of the charity’s objects or is legitimately incidental to them.
- The amount of private benefit should be reasonable.
- Charges should be reasonable and should not exclude a substantial proportion of the beneficiary class.
- The service provided should not cater only for the financially well off. It should in principle be open to all potential beneficiaries.

These principles for judging public benefit are basically sound. The case for continuing to look at the public benefit that charities offer is discussed below.

## Difficulties with the current definition

4.8 There are a number of weaknesses in the way that charitable status is currently determined.

4.9 The law is confusing and unclear. The four “heads” do not accurately represent the full range of different types of organisations with charitable status today, nor the range of organisations that should have charitable status.

<sup>27</sup> RR8 The Public Character of Charity.



There also seems little logic behind the presumption that organisations falling under the first three “heads” provide a public benefit, whilst those under the fourth have to prove public benefit. Finally, there is confusion over the extent to which self-help and mutual organisations can have charitable status, and the acceptable level of private benefit to individuals generally.

## Objectives for reforming charitable status

4.10 This review has sought to develop a new definition of charitable status which meets the following objectives.

- To clarify what constitutes charity in the 21st century.
- To change the parameters of charitable status, to include organisations which provide a clear public benefit, but which are currently either on the borderline of charity, or are denied it at present.
- To retain the flexibility of charity law to evolve as social and economic circumstances change, and to provide better ways of keeping the law up-to-date.
- To emphasise the public character of charities.

## Emphasising public benefit

### *Activities rather than purposes?*

4.11 Some have argued that the best way to emphasise public benefit would be to base charitable status on activities, rather than purposes. However, the main advantage of focusing on stated purposes is that it allows for flexibility in how the organisation chooses to achieve these purposes. This gives organisations the independence to undertake the activities they deem most effective in achieving their

purposes, as well as the flexibility to respond to problems in new and innovative ways. It is not widely appreciated, however, that the tax reliefs associated with charitable status already depend on funds being *applied* to charitable purposes. A stricter activities test would also imply a degree of state oversight and control of voluntary organisations that would be onerous and stifling of initiative and innovation.

### *A new definition of charity encompassing a broader range of public benefit purposes*

4.12 The current classification of charitable purposes into four “heads” is insufficient to correctly reflect the range of objects that can be charitable. An expanded list of purposes would make the overall framework much clearer both for charities and for the public.

4.13 The new purposes set out in Box 4.2 are not designed to be an exhaustive list. They are framed in general wording around which case law can continue to develop. The tenth purpose, “Other purposes beneficial to the community” will continue to cover all the organisations which are currently charitable and whose purposes fall outside the main categories. The definition will therefore retain sufficient flexibility to allow new organisations to become charitable as society’s understanding of what is beneficial to the community develops.

4.14 The wording is carefully chosen to avoid inadvertently excluding organisations that are already charitable. The purposes are chosen to represent the main areas of charitable activity that can reasonably be anticipated to continue to represent a public benefit. All except Purposes 7 and 8, which remove current anomalies (see paragraphs 4.36 and 4.41 onwards) derive from existing purposes and case law. Purpose 1 is expanded from “relief of poverty” to both the “prevention and relief of poverty”.





### *Box 4.2: A new definition of charity*

A charity should be defined as an organisation which provides public benefit and which has one or more of the following purposes:

1. The prevention and relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. The advancement of health.<sup>a</sup>
5. Social and community advancement.<sup>b</sup>
6. The advancement of culture, arts and heritage.
7. The advancement of amateur sport.
8. The promotion of human rights, conflict resolution and reconciliation.
9. The advancement of environmental protection and improvement.
10. Other purposes beneficial to the community.

a including the prevention and relief of sickness, disease or of human suffering.

b including the care, support and protection of the aged, people with a disability, children and young people.

### *The case for retaining public benefit at the heart of charity*

4.15 The Government considers that public benefit should continue to be one of the essential requirements of charitable status. Both the recent report by the National Council for Voluntary Organisations on the definition of charity<sup>28</sup>, and the Scottish McFadden report<sup>29</sup>, reiterate the central importance of public benefit to the concept of charity. A recent opinion poll conducted by NCVO confirmed that 88% of those asked agreed that a registered charity should be able to demonstrate that its activities provide a benefit to society. The response was particularly strong amongst 18-24 year olds, where 95% agreed.

4.16 Although the acceptable level of public benefit can be difficult to judge, this does not diminish its relevance. Removing this concept from the definition of what is charitable and

replacing it or combining it with another, untested concept – such as altruism as has been suggested in Australia<sup>30</sup> – would create unacceptable uncertainty in law, and would have few advantages.

4.17 Much consideration has been given to whether it is desirable to define charitable status purely in terms of public benefit, without any categories at all. Whilst this has the attraction of appearing both simple and consistent, it is in practice difficult to devise a workable definition which would not need extensive secondary legislation and guidelines, which could be more complex than a definition using categories. There is also a danger that such an approach would lead to too much government interference in the detail and to frequent changes in what is acceptable in terms of public benefit. The uncertainty of adopting such a new definition could be damaging to the sector.

<sup>28</sup> NCVO (2001). For the Public Benefit? A Consultation Document on Charity Law reform.

<sup>29</sup> The report of the Scottish Charity Law Review Commission, 2001 (known as the McFadden report after the Chair, Jean McFadden).

<sup>30</sup> Report of the Inquiry into the Definition of Charities and Related Organisations, June 2001.



4.18 This review recommends that there is a need to retain the centrality of public benefit in the definition of charitable status, and to ensure that all organisations that enjoy charitable status provide a public benefit. In applying a public benefit test, charity regulation needs to address two main issues:

- the definition of public benefit; and
- the consistency of the application of the public benefit test.

At present the decision on whether a particular charity has a public character is based on case law. Case law provides a number of principles on what counts as public benefit. However there is a need to apply the public benefit test more consistently. Under the new ten purposes of charity, all charities will have to demonstrate public benefit. There would not therefore be a presumption that certain categories are for public benefit, although this will not lead to the removal of charitable status for whole categories of organisations like churches (see paragraphs 4.19 - 4.40 below). There is also a need for a more systematic programme to check the public character of charities – which is currently only considered on registration. The Charity Commission should therefore undertake a rolling programme which reviews public character (see paragraphs 4.26 - 4.30 below). The advantage of the case law approach is that it takes account of the huge diversity of the sector and has the flexibility to evolve over time. But, testing public benefit in court is costly and the outcomes uncertain. This means that important issues of principle need to be evident before the Charity Commission takes any case to court. An alternative option would be for legislation to define more clearly how public benefit is to be demonstrated for a purpose to be charitable. However trying to define public benefit in law in a way which was meaningful across the charitable sector would not be straightforward. Furthermore, removing

all references to existing case law would also create uncertainty. The government considers that there are advantages in continuing with an approach based on case law but would welcome views on these alternative options.

**Recommendation:**

***That charity be redefined in law, based on the principle of public benefit and falling under one of ten new purposes of charity.***

### **Application of the new definition**

#### *Effect on existing organisations*

4.19 None of the objects currently recognised as charitable will be excluded. For example, animal health and welfare will continue to be included under 'other purposes beneficial to the community'.

4.20 Voluntary participation in the range of areas spanned by charity is critical because it promotes active citizenship, which is vital for building strong communities and ensuring that those who live in them are at the forefront in making the decisions which affect them. Most forms of active citizenship – except those which are political – will continue to be charitable under one of the ten purposes as will the promotion of active citizenship as a means to achieving a charitable objective.

#### *Recognition of new purposes in the future*

4.21 The independence of the sector is highly prized and it is not the intention of the review to undermine this. The decision to amend the law is not taken lightly and the new definition is intended to last for some considerable time. There are fears that a statutory definition will create a precedent for future governments to meddle with the definition of what is charitable. The Government has already legislated in this area once before<sup>31</sup> and this did not lead to a spate of further legislation. The intention is that this will be a one-off change to the parameters that will help secure the position for the future.

<sup>31</sup> The Recreational Charities Act 1958.



4.22 It is anticipated that the interpretation of charitability will continue to evolve as social and economic circumstances change. Sometimes, this will happen through court decisions. More often, it will be through changes of interpretation by the regulator, or by the new appeals tribunal that is proposed (see Chapter 7).

#### *Flexibility in objects*

4.23 Organisations will continue to be able to have objects encompassing more than one purpose, and charities such as grant giving trusts would continue to be able to have 'general charitable purposes' objects to give them the maximum flexibility in the giving of grants.

#### *Application of case law*

4.24 Although in some areas anomalies have arisen under the current law, there is also a body of helpful case law that has considered specific questions, such as in the scope and meaning of education in the context of charity law. It is not the aim of this reform to do away with existing case law. Removing all reference to existing case law would create significant uncertainty for existing charities, and would mean that many of the same points would have to be unnecessarily explored again by the courts.

#### *The charitability of self-help organisations*

4.25 Self-help organisations are important in that they empower beneficiaries to help both themselves and others. Our consultation revealed that there is confusion over whether self-help organisations can obtain charitable status. At present, self-help organisations which have open membership may be charitable, but organisations run by a small number of people for their own benefit cannot. This distinction helpfully draws a line between private and public benefit.

#### *The public character of charities*

4.26 Some charities charge fees for the provision of services. Charging fees that are affordable to large sections of the population will not affect the public character of the charity. However, those charities that charge have to ensure that they have a public character, that is, that they provide access for those who would be excluded because of the fees. For example, to maintain their charitable status, independent schools which charge high fees have to make significant provision for those who cannot pay full fees and the majority probably do so already.

4.27 However, at present there is no systematic programme in place to check the public character of charities. This is only considered on registration. An on-going review programme run by the Charity Commission should check the public character of such organisations.

4.28 It is proposed that the Charity Commission would identify charities likely to charge high fees and undertake a rolling programme to check that provision was made for wider access. This programme will be designed to minimise red tape and will not focus on any particular sector. It will only affect those small numbers of charities which charge fees which serve to exclude large sections of the public. Short returns will be issued which ask charities what they do in terms of widening access, such as making provision for sharing facilities. It is envisaged that for the majority of cases no further enquiry will be necessary beyond the initial return.

4.29 This review would be based on the Charity Commission's existing criteria (see paragraph 4.7) and case law concerning access. It is proposed that the Commission, in consultation with charities likely to be affected and their umbrella bodies, will issue guidelines as to the level of access appropriate in particular circumstances.

<sup>32</sup> The Goodman, McFadden and Deakin reports.

4.30 Where access is considered inadequate, the programme would be run in such a way as to allow under-performing organisations to develop their provision of public benefit rather than immediately losing charitable status. Organisations will of course have full rights of appeal against Charity Commission decisions in this area.

**Recommendation:**

***The Charity Commission should undertake on-going checks on the public character of charities***

***Analogy to the preamble***

4.31 There is some debate as to whether analogy to the 1601 Statute is still relevant. Many of the purposes listed either no longer appear relevant or may no longer be considered for the public benefit. Case law has also moved on and developed considerably. Previous reports<sup>32</sup> on charity law have recommended that analogy to the Statute should be removed. With the new statutory definition, objects will be accepted over time by analogy to existing case law, or based on evidence of public benefit from first principles.

***Interpretation***

*The advancement of religion*

4.32 The retention of advancement of religion as a category of charity underlines the fact that religious faith and worship continue to have a significant role to play in society. Religion also motivates giving to other charitable causes and many religious organisations contribute significantly in a wide range of pastoral activities in the community. And many of the largest and best-known charities have a religious origin.

4.33 The proposed removal of the presumption that religious organisations provide a public benefit might cause concern as to how such organisations will demonstrate public benefit.

The aim of this reform is not to force churches to undertake community activities such as social services for older people or the sick, although many of course already do. Religious practice tends generally to contribute to the social and moral welfare of adherents. It is not proposed to change the principle that celebration of a religious rite which is open to the public should be regarded as providing public benefit. In accord with existing case law, the Charity Commission currently applies public benefit tests to religious bodies seeking registration. Removing the legal presumption will not affect this approach. Demonstrating public benefit should, therefore, cause no difficulty for established religions, and should continue to ensure that the registration of harmful organisations is avoided.

4.34 It is also proposed the current interpretation of religion be widened. Case law has tended to define only monotheistic faiths like Christianity and Islam as religious. Under the new purpose of Advancement of Religion it is proposed that the legislation introducing the change clarify that faiths that are multi-deity (such as Hinduism) or non-deity (such as some types of Buddhism) should also qualify.

*The advancement of amateur sport*

\* A more detailed paper ***Sport and Charitable Status*** on the Website gives more detail on these recommendations.

4.35 Sports clubs play an important role in society. They provide health benefits to participants, giving them a better quality of life, and they can be effective in encouraging participation and forging stronger communities.

4.36 Until recently, however, these benefits were not always recognised in charity law. As a rule, only organisations which provided multi-sport facilities, or those involved in sport as a means to a charitable end (such as helping disabled people), could qualify for charitable status.



4.37 Recently, as part of its Review of the Register process (which looks at the charitability of particular groups of organisations), the Charity Commission announced that “community participation in healthy recreation” should be recognised as a charitable purpose. Their guidelines would admit many community amateur sports clubs, but also exclude a substantial number, including those which have social (non-playing) members, or which give preferential treatment to players with higher ability at the expense of those who are less able.

4.38 This report proposes to build on the Charity Commission’s work by explicitly recognising amateur sport as a charitable purpose. It is intended that “sport”, rather than being based on a list of eligible activities, should be defined as encompassing activities involving an element of physical skill which promote and maintain health. Clubs which select their members on the basis of ability, or which set a minimum standard of fitness or competence for membership would still be eligible for charitable status. Having social members will no longer automatically exclude a club from charitable status.

4.39 Sports clubs would of course not automatically qualify. Along with all other charities, they would have to show that they provide a public benefit and comply with guidance on charging (discussed in 4.27 onwards).

*The promotion of human rights, conflict resolution and reconciliation*

4.40 Including the promotion of human rights as one of the ten charitable purposes would confirm that the promotion of human rights – adopting either the definition in the European Convention, or that in the UN’s International Bill of Human Rights – is a charitable purpose. It would be for organisations themselves to define which “human rights” they were concerned to

promote, and where. We propose that any doubts about the charitable nature of the purpose of promoting conflict resolution and reconciliation should also be resolved by specifying this (as distinguished from the promotion of pacifism) as a charitable purpose

4.41 This will allow charities to play their full part in the vital tasks of protecting human rights both in the UK and overseas, and of rebuilding communities in areas that have suffered from conflict. Charity law rules on campaigning and political activities (see paragraphs 4.49 – 4.50) will not allow charities in these areas to have political purposes but will allow them to pursue “political” activities – such as advocating changes in laws or in the policies of governments – as long as those activities are carried out in a balanced and rational way and contribute directly to achieving their charitable human rights or conflict resolution purposes.

## Encouraging entrepreneurialism

### *The importance of trading to charities*

4.42 Income from contracts and trading makes up one third of the total income of general charities<sup>33</sup>. This proportion seems likely to rise still further, as charities are becoming less reliant on grant funding, and more involved in providing services for local authorities or government under contract.

4.43 Equally, fundraising techniques increasingly tend to involve some kind of trading activity – such as the sale of Christmas cards – rather than asking for a straight donation. Earned income from the public amounts to 14.6% of overall income for general charities, less than the amount received in donations but still a very significant sum.

<sup>33</sup> NCVO (2002) The UK Voluntary Sector Almanac, 2002.



### *The law on trading*

4.44 Currently, charity law permits charities to undertake trading that is directly connected with, or is ancillary to, furthering their charitable purposes. Examples might be a theatre which charges for tickets, or a care charity charging the local authority for providing services under contract. It is also permissible for a charity to undertake a small amount of trading for fundraising.

4.45 However, any charity that wishes to undertake substantial trading for the purpose of generating income, rather than in direct pursuit of its purposes, has to set up a trading company to do so. An example of this type of trading would be a theatre which opens a restaurant that caters for both audiences and the general public. The charity can receive any surpluses on this trading activity tax-free by using Gift Aid to transfer them back.

4.46 In practice, this means that a charity can undertake any trading activity it likes and can be exempt from most taxes, so long as it sets up a separate organisation to do so. The rationale for this is to isolate assets from risk and making financial flows between the charity and the trading activities transparent. The difficulty with the system is that it is administratively complex, expensive for

individual charities, and can inhibit them from diversifying their income streams. Deregulating the system would allow charities to continue to trade as they currently do, but remove the need for a separate trading company.

4.47 This will not mean that it is right for every charity to undertake substantial trading; the decision will be for the individual trustees with professional advice, if necessary. Specific statutory duties of care will apply to trustees who take the decision to trade. These duties are designed to mirror existing good practice, and most trustees will be used to taking these points into account already when considering new activities.

***Recommendation:***

***To amend charity law to allow charities to undertake all trading within the charity, without the need for a trading company. The power to undertake trade would be subject to a specific statutory duty of care (see Box 4.3).***

4.48 This change would be largely tax neutral, but would remove an unnecessary administrative burden.

### *Box 4.3: Proposed trustee duties in relation to trading*

The following new duties would apply to trustees of charities involved in trading:

- A duty of care along the lines of that in the Trustee Act 2000.
- A duty to give proper consideration to the need to structure the trade in a way which does not expose the assets of the charity to significant risk
- A duty to take proper (professional) advice in connection with the establishment, exercise and discontinuance of the trade.
- A duty to consider the suitability to the charity of trading as a form of income generation, and to consider the suitability for that purpose of the particular trade or proposed trade.
- A duty to compare the economic benefits of the trade or proposed trade with other forms of income generation open to the charity.



## Enabling charities to advocate effectively

### *Restrictions on campaigning activities*

4.49 Many not-for-profit organisations advocate and campaign for change on behalf of their beneficiaries. In carrying out this advocacy and campaigning role, not-for-profit organisations are regulated in the same way as other organisations, according to electoral law, the standards and codes of practice relating to public order, advertising and the rights of petition. Those organisations which are charitable must also comply with the requirements of charity law, and must adhere to Charity Commission guidelines as to the amount and type of political activity that can be undertaken.

4.50 Charities cannot have political objects. This means that they cannot be established with the aim of furthering the interests of a political party or securing or opposing any change in the law or policy and decisions of a government, whether in this country or abroad. Charities are able to undertake some non-party political activities in furtherance of their charitable purposes, but the law is notoriously unclear as to precisely what activities are and are not allowed.

### *The case for change*

4.51 The restrictions imposed on charities are somewhat anomalous. There are no restrictions on the campaigning or advocacy of businesses, for example, and in many continental European countries for example, France, Netherlands and Sweden there are no comparable restrictions on not-for-profit organisations.

4.52 Furthermore, there are a number of reasons why it is desirable to encourage, rather

than restrict, charities' advocacy and campaigning role:

- Their strong links into local communities mean that charities are particularly well placed to monitor, evaluate and comment upon policies as they are implemented.
- Charities still enjoy higher levels of public trust and confidence than politicians or established political institutions, and are therefore well placed to offer alternative ways of engaging with the public policy debate and the processes of democracy.
- The diversity of the causes represented by charities mean that they are able to give voice to a far wider range of political perspectives, including those of minority groups or interests, than might otherwise be heard by government.

4.53 However, these advantages need to be balanced against the fact that maintaining levels of trust and confidence depends crucially on preserving the charity 'brand'. This can only be done if people continue to believe that charities, in speaking out on issues of public interest, are free from the influence of political or other vested interests.

4.54 It is worth noting that as part of the Compact<sup>34</sup>, the Government has already undertaken to support the sector's right to campaign and comment on government policy – irrespective of any funding relationships that may exist. This now needs to be reinforced by reassurance in the regulatory guidance given to charities that they are free to undertake a range of campaigning activities.

4.55 The current Charity Commission guidelines give examples of which activities would be acceptable and which would not. They lay down general prescriptions which are illustrated by specific concrete examples. Although the case law is clear that political

<sup>34</sup> "Compact on Relations between Government and the Voluntary and Community Sector in England", 1998.



objects are not charitable, the case law on political activities is far less substantial. However, the current Charity Commission guidelines do suggest that there could be regulatory consequences for charities which departed from the guidelines.

4.56 The guidelines are also written in a somewhat cautionary style which could be said to overplay the potential difficulties of campaigning work. Moreover, although many organisations, especially at the smaller end, do welcome guidance based on concrete examples, there is a potential danger that being over specific creates uncertainty over whether activities which are not specified in the guidelines are acceptable. In doing so, it encourages trustees to be conservative and not to make best use of their managerial autonomy.

**Recommendation:**

***That the Charity Commission guidelines on campaigning should be revised so that the tone is less cautionary and puts greater emphasis on the campaigning and other non-party political activities that charities can undertake. The legal position should continue to be that charities can campaign providing that:***

- ***a charity's activities are a means to fulfilling its charitable purpose;***
- ***there is a reasonable expectation that the activities will further the purposes of the charity and benefit its beneficiaries, to an extent justified by the resources devoted to those activities;***
- ***its activities are based on reasoned argument; and***
- ***its activities are not illegal.***

***The Charity Commission should distinguish between this position, which is statement of legal and regulatory requirements, and good practice. It may wish to publish advice on good practice, but in doing so should***

***emphasise that trustees have the freedom to pursue whatever activities they judge to be in the best interests of the charity.***

## Providing flexibility to evolve

4.57 The review has identified a number of small but important barriers that charities face if they want to change their objects or update their constitutional documents, whether this is to allow the existing organisation to develop and change, or whether it is a precursor to a merger.

4.58 Removing unnecessary barriers will give trustees more flexibility to reorganise the way in which they operate, and give the regulator a greater ability to facilitate changes quickly and cheaply. This will be combined with a more proactive and supportive role by the regulator.

## Mergers

4.59 Charity mergers are the subject of much debate within the sector and the press. Research shows that a large number of charities are already involved in joint working, on the delivery of a particular project, for instance, or for fundraising purposes. In other areas there are barriers to working collaboratively. And some trustee bodies, often for entirely legitimate reasons, do not want to do so.

4.60 Sometimes joint working can lead to an eventual merger. It is important to realise that mergers can be time-consuming and expensive, and are not always successful. However, there is an increasing amount of research into the factors that lead to successful mergers in the charity sector, which draws out the importance of strategic planning and stakeholder management throughout the process.

4.61 We do not see the role of government as one which should force, or even try to persuade, independent organisations to merge. However, the legal and regulatory framework



### *Box 4.4: Legal measures to facilitate the evolution of charities and mergers<sup>a</sup>*

- Charity Commission review to be undertaken with the aim of relaxing the conditions for changing a charity's purposes<sup>b</sup>.
- Raise the threshold allowing small charities to make certain changes (such as transferring assets and modifying objects) from £5,000 to £10,000 annual income. The criteria and procedure for transferring property or changing objects will be broadened and simplified.
- Make it easier for trustees to make administrative amendments to their governing documents. The Charity Commission already has orders in place which speed up amendments of governing documents.
- Speed up the formal scheme<sup>c</sup> making procedure (the Charity Commission already provides 'Schemes on the Internet'), and reduce the cost to charities by making advertising the changes a matter of Commission discretion.
- Include specific provision in the Charitable Incorporated Organisation (see 5.43-5.46) legislation to facilitate transfers and mergers.
- Provide for the benefit of all future legacies and gifts to transfer automatically to the newly incorporated or merged charity.
- Produce regulatory guidelines on due diligence in charity mergers, based on a light-touch approach.

<sup>a</sup> These and other proposals are set out in more detail in a paper on the web ***Providing flexibility for charities to evolve and merge\****.

<sup>b</sup> Under the *cy-près* doctrine where assets are applied to another purpose as near as possible to the original or intended purpose.

<sup>c</sup> A scheme is a legal document by which the Charity Commission may amend, replace or amplify a charity's governing documents.

should be set up in such a way that a merger is facilitated when trustees believe that it is in the best interests of the charity. The Charity Commission already carries out significant helpful work to facilitate mergers, a recent example being Cancer Research UK, and more charities could be helped in this way.

4.62 There can be technical barriers to merger which can discourage sensible proposals. There is scope for more flexibility being introduced into the legal framework.

\*The paper ***Providing flexibility for charities to evolve and merge*** gives further detail.

#### **Recommendations:**

***That the Charity Commission should provide specific advice to facilitate mergers, possibly by creating a dedicated internal unit.***

***That a package of legal measures<sup>35</sup> should be introduced that will facilitate mergers and, more generally, the administrative running of the charity (see Box 4.4)***

#### ***Flexible use of endowments***

4.63 Permanent endowments are funds where the trustees are only permitted to spend the income but not the capital. They are commonly created at the request of a donor, who wants to use a large sum to provide an income for a particular cause, or because of the way in which

<sup>35</sup> Either in primary legislation or under the Regulatory Reform Act 2001.

a charity's constitution is written. However, some charities have a number of small endowments, some of them very old, where their retention as capital is no longer in the best interests of the charity.

4.64 At the moment, charities with an income of £1,000 or less are allowed to pass a resolution to spend their permanent endowment as if it were income if they are of the opinion that the property of the charity is too small, in relation to its purposes, for any useful purpose to be achieved by the expenditure of income alone<sup>36</sup>. The trustees have to advertise the proposed conversion and notify the Charity Commission, which must concur with the proposal before it can proceed.

4.65 This allows very small charities to convert their endowment into expendable capital in some circumstances, but it does not allow larger charities with small non-expendable endowment funds to do so in any circumstances. We propose the following changes which will help both small and large charities:

- the power to convert permanent endowment funds to expendable capital should continue to be available for any charity with an income of £1,000 or less;
- any charity with an income of more than £1,000 should be able to convert any permanent endowment fund having a capital value of £10,000 or less to expendable capital;
- the test described in paragraph 4.64 should be relaxed so that, for all charities, conversion can take place when the charity believes it can more effectively fulfil its purposes by converting the endowment to expendable capital;

- charities should no longer be required to advertise the proposed conversion, and the requirement for the Charity Commission's concurrence with it should be removed.

4.66 For charities above the £1,000 income limit the Charity Commission should be able to authorise conversion of permanent endowment funds worth more than £10,000 if:

- the trustees can demonstrate that this will enable the charity to more effectively fulfil its purposes; and
- the Commission is satisfied that conversion is consistent with the spirit of the gift which created the endowment, taking into account any changes in the charity's circumstances since the gift was made. It is important that donors who give money with the specific intention that it will form a permanent capital endowment should not have their intention overturned lightly or on slender grounds.
- For conversions of these larger endowments advertising any proposed change will be at the discretion of the Charity Commission.

4.67 These changes will give charities greater flexibility to evolve and enable them to meet their objectives in the most effective way.

4.68 These reforms will not affect the Charity Commission's policy on Total Return, which the Government endorses. More details of this can be found on the Charity Commission website<sup>37</sup>.

**Recommendation:**

**Criteria for allowing trustees to spend capital should be revised as set out above.**

<sup>36</sup> s75 Charities Act 1993.

<sup>37</sup> <http://www.charity-commission.gov.uk/supportingcharities/ogs/index083.asp>.

## **5. REFORMING THE LEGAL FRAMEWORK: A RANGE OF LEGAL FORMS ENABLING NOT-FOR-PROFIT ORGANISATIONS TO THRIVE**

### **Summary**

- As charities and other not-for-profit organisations grow, they often need to establish a legal personality of their own.
- There are no corporate forms designed for charities. Those available to social enterprises are also not well suited to their needs: they lack adequate protection of assets and a strong brand, and can create difficulties in raising finance.
- The creation of a new legal form for social enterprises, the Community Interest Company, would protect assets against distribution to members or shareholders, and create a strong new not-for-profit brand for small scale community-based social entrepreneurs.
- The Industrial & Provident Society structure is a useful, but under-used, under-recognised and outdated form. The legislation should be modernised, with the main changes being:
  - renaming organisations as Co-operatives and Community Benefit Societies;
  - raising the voting thresholds for conversion, in line with current rules for building societies;
  - giving Community Benefit Societies the option of protecting their assets in perpetuity for a public purpose; and
  - ensuring that Industrial & Provident Society legislation is kept up to date with developments in company law.

- **Although the company form is popular with many charities, ambiguity over areas of overlap and differing requirements between company and charity law means that sometimes trustees are confused about their obligations. The Charitable Incorporated Organisation is a new legal form specifically tailored to charities, which would remove these difficulties.**

This chapter considers:

- the reasons why organisations may wish to set up a legal identity;
- the diversity of the social enterprise sector, and what this means in terms of their requirements of a legal form;
- the proposal to set up a Community Interest Company;
- changes to the Industrial & Provident Society structure;
- a branding scheme for social enterprise; and
- a new legal form specifically for charities.

## Why incorporate at all?

5.1 Many charities and other not-for-profit organisations exist at a small scale at community level, run by groups of committed individuals in an informal manner. However, as an organisation grows and takes on more responsibilities, those running it often want to formalise its existence by turning it into an entity with its own legal personality – in other words, to incorporate.

5.2 The main reasons for incorporation are:

- to bring together a group of individuals in pursuing a task or mission;
- to ensure accountability to stakeholders;
- to mobilise resources and manage assets; and
- to limit liability and to give an organisation a life beyond that of its founders.

5.3 But there are also drawbacks in incorporating. One is the cost, both of registration and of on-going compliance with the relevant law and regulation. This can be a particular issue for charitable companies, which find themselves facing separate regulatory requirements under both charity and company law. Another is that it may be hard to find a form (or a group of forms) that suits the way the organisation works. Some legal forms, for instance, impose restrictions on financing or on aspects of governance. These might be difficult to reconcile with the way in which a charity or a not-for-profit organisation wishes to structure itself.

## Forms of incorporation for social enterprises

### *Social enterprises are a diverse group...*

5.4 Social enterprises are organisations which, like mainstream businesses, trade in order to build long-term sustainability, but which operate for a social purpose and use their profits for this end. They are an enormously diverse group of organisations, as the examples given in this section show. These by no means give a comprehensive picture of the sector, but do illustrate its diversity.

5.5 The sector includes organisations which are close in structure, although not in ethos, to mainstream business. The Day Chocolate Company, for instance, plans to distribute



profits to its shareholders, although it has broad social aims (paying farmers a decent price for their cocoa; promoting fair trade in the industry and amongst consumers). The Ghanaian farmers' co-operative which produces the cocoa is a major shareholder, and all the other shareholders share the aims of the company.

**Day Chocolate Company**, London aims to put quality and affordable fair trade chocolate into the mainstream market, raise awareness of fair trade issues, be a catalyst for change in the mainstream markets and pay a fair trade price for cocoa. Day is a joint venture private shareholder company with one third of the ownership by Kaupa Kokoo, a farmers co-operative in Ghana, and the rest by Twin Trading (fair trade) and the Body Shop.

5.6 Many social enterprises see themselves as distinct from charities, the latter having traditionally relied on donations and grants. However, as charities have become more commercial and entrepreneurial, many now consider themselves to be part of the social enterprise sector. For instance, the Apex Leicester Project see themselves very much as a social enterprise, but are a registered charity.

**Apex Leicester Project** provides advice, guidance, support and training for disadvantaged unemployed people, particularly ex-offenders. They are a registered charity and a company limited by guarantee but describe themselves as social entrepreneurs running a business, which provides an excellent service. Much of their income is from service level agreements and contracts. They are developing fee income and considering building an asset base.

5.7 Many organisations which are governed or owned by their staff – rather than by the providers of capital, as is the case with conventional business - also class themselves as social enterprises, Poptel being an example.

**Poptel** is the UK's leading employee co-operative internet service provider, aims to enable organisations to work for positive social change and to help them achieve their goal by using up-to-date technologies. Employees are members of Soft Solution Ltd which has a 75% stake in Poptel Ltd, the operating company. Their collective shareholding is held in the Soft Solution Employee Benefit Trust.

5.8 A further example of a type of enterprise is the social firm, an organisation which works in a conventional business area such as mail-order goods, but which employs a high proportion of people who might otherwise not get work. One such firm is AnyBodyCan.

**AnyBodyCan** is a social firm dedicated to challenging social and economic exclusion by supporting the development of enterprise and social entrepreneurship to better enable the inclusion of disabled and otherwise disadvantaged people. A newly established membership organisation and company limited by guarantee, it holds a stake in Katalyst, an events management company.

*...with particular needs, which are not currently met*

5.9 The distinctive aims, governance structures and financing methods used by the social enterprise sector, which are illustrated by these examples, present challenges in choosing an organisational form.

5.10 The aims of social enterprises are social, rather than to make profits for owners. What they do falls between the charitable and the commercial - a middle ground which is, at present, poorly recognised. Formal governance structures, and lines of accountability, are less clear-cut than for the public or private sectors, often involving a wide range of stakeholders. Many social enterprises, for instance, are ultimately accountable to their users, members or staff, rather than – as is the norm with most private companies – their providers of capital. And since social enterprises usually re-invest any surplus they make in their business, rather than distributing it to the owners of the organisation, conventional equity is often not an appropriate form of financing.

5.11 The forms of incorporation available to these enterprises must therefore recognise their fundamentally distinctive ethos, whilst remaining flexible enough to apply to a very wide range of organisational styles and structures. The current legal forms available fall short of these standards, for the reasons set out in Box 5.1.

5.12 This report therefore proposes two important reforms which are aimed at providing modern, flexible and accessible forms of incorporation for the fast-growing social enterprise sector: the creation of a new legal form drawing as appropriate on companies legislation, the Community Interest Company, and modernisation of the I&PS structure.

\* Full details of the background to these proposals are contained in the paper ***Organisational forms for social enterprise.***

5.13 These reforms are aimed at non-charitable organisations, and will complement the introduction of a new legal form for charities (discussed below).

### ***Locking in assets for the benefit of all***

5.14 A central feature of these reforms is that they would introduce a way of protecting the assets of not-for-profit organisations, so that they could not be distributed for private benefit. Instead, the assets would have to be used for some kind of public purpose, or for the

### ***Box 5.1: Difficulties with the current range of legal forms for social enterprises***

**Lack of protection of assets.** It is not currently possible to prevent the members or shareholders of an organisation from voting to sell or dissolve it, and to split the proceeds from the sale of the assets (the equivalent of demutualisation in the building society sector).

**Weak brand and poor recognition.** The social enterprise business model in general is poorly understood. In particular, the Industrial & Provident Society (“I&PS”) is not well recognised, and I&PS law is not as well developed as company law. This lack of knowledge impedes the creation of new social enterprises.

**Difficulties in raising finance.** Some legal forms impose limits on the type of finance that can be obtained – companies limited by guarantee, for instance, cannot raise equity; I&PSs face limits on the amount of equity that any one member can hold. Their weak brand makes financiers wary and increases the cost of funds.

**Expense of registration.** Registration as an I&PS is expensive relative to company registration and takes longer, as the process is more complex.

benefit of members. At present, this protection is only available for charities, or through mechanisms such as regulation or sector-specific legislation, which can be cumbersome.

5.15 In the case of I&PSs, increased protection of assets is proposed. Community Benefit Societies should have the option of locking their assets irrevocably to certain social objectives (this is inappropriate for Co-operatives, being purely member benefit organisations). An irrevocable lock is also proposed for all Community Interest Companies.

5.16 By making it possible for organisations which are not charities to protect their assets in law in this way, these changes will pave the way for growth in the sector. The protection of assets – alongside the limits on profit-sharing which are already present in one type of I&PS, and which are envisaged for the Community Interest Company - will prevent private individuals from profiting from organisations set up to serve a wider purpose. It will also give funders, such as charitable trusts and government agencies, greater confidence that their money will be used for the purpose for which it was given.

5.17 The purpose of the lock on assets is not to protect the organisation itself from change or take-over. That would risk shielding inefficiency. It is the assets, not the organisation using them, that would be protected. So an organisation could be taken over – but the proceeds from the transaction would have to be distributed to another organisation to be used for a similar purpose. Robust mechanisms would have to be put in place to ensure that takeovers, mergers and dissolutions are conducted in a fair and transparent way.

5.18 Similarly, it would be counter to the whole ethos of the sector if an organisation, once set up, could never evolve and change its purposes and activities. It is envisaged that such changes would be made as easy as possible – so long as the new purposes were still ones which fulfilled public or member interests.

## The Community Interest Company

### *Why do social enterprises choose to be companies?*

5.19 The company form is attractive to many social enterprises. Company law is well developed, and companies are well understood by professionals such as bankers and lawyers. The company limited by guarantee form in particular is popular, and is used by some very large not-for-profit organisations such as BUPA, the private health provider.

5.20 Against the popularity and strong image of companies, however, must be balanced the fact that the companies legislation was not designed with the needs of smaller scale community-based social enterprises in mind. Problems include the fact that there is no entrenchment of the non-profit-distributing nature of the organisation, nor the devotion of assets to a public purpose; that the Company Limited by Guarantee does not allow access to equity; and that the company “brand” is almost exclusively associated with profit-making.

### *Creating a Community Interest Company for community-based enterprises*

5.21 This report therefore recommends the establishment of a Community Interest Company (“CIC”), drawing as appropriate on company law, but with certain additional constraints and features which make it suitable for use by small scale community-based not-for-profit social enterprises familiar with the company form.

#### **Recommendation:**

***That a Community Interest Company be established, with the characteristics set out in Box 5.2.***

### Box 5.2: Characteristics of the Community Interest Company

- Protection of assets against distribution to members or shareholders.
- Ability to choose the limited by guarantee or by shares format, with full adherence to UK and European company law and guidelines, including rules on insolvency, accountancy, and governance.
- Ability to issue preference shares with a fixed rate of return (this applies to both the limited by guarantee and limited by shares models).
- Increased requirements in terms of transparency and accountability.
- A requirement to have a clause in the constitution setting out the objects of the company.
- A check at the point of registration that the objects of the organisation are in the public and community interest, with subsequent changes being subject to regulatory approval.

#### *Asset protection*

5.22 Protecting the assets of a CIC would not mean that the company was protected against take-over, or that it could never be dissolved. But if a CIC were closed down or taken over, the proceeds from the sale would have to be used for similar public interest purposes – either by an existing organisation, or by a new body. This is analogous to what happens when charities fold, and also to the regulations governing non-profit corporations in the US.

#### *Financing*

5.23 Not-for-profit organisations are aware of the advantages of having some form of share capital as part of their overall financing mix. CICs, unlike for-profit companies, would not have the objective of maximising profits and dividends, meaning that ordinary shares with profit-related dividends would be inappropriate.

5.24 However, CICs – whether they take a limited by guarantee or limited by shares structure – would be able to issue preference shares with a fixed nominal return, or a return which is pegged to an economic variable, such as inflation or the Bank of England base rate. Preference shares are a very flexible form of capital. Payment of dividends to preference shareholders could be reduced or not paid in

years of unexpectedly low revenues, thus providing a risk cushion. Shares could be either perpetual or redeemable, and dividends could be cumulative (whereby underpayments must be made up in subsequent years) or non-cumulative. Preference shareholders may have voting rights or not, as determined by the terms of the issue.

5.25 CICs could also access the debt markets, and they might find Community Development Finance Institutions a valuable source of funds. The rapidly growing number of ethical investment funds may find CICs an attractive investment.

#### *Governance*

5.26 CICs would be free to adopt a range of governance structures, just as companies currently are. The limited by guarantee form of the CIC would be likely to be appropriate for most organisations, as its membership structure would be flexible enough to be used to set up fully mutual organisations as well as ones with a membership which was representative of different groups of stakeholders. All CICs would be expected to follow the principles of good corporate governance developed over the past decade in the combined code and any successors.





### *Transparency*

5.27 Additional transparency requirements could include a right for members to see all the company's records and documents (except where they can be shown to be commercially confidential).

### *Public Interest Test*

5.28 All CICs would be required to have objects which are in the public and community interest. These would be stated in the constitution, and directors would be under a duty to pursue them. In contrast, the independent Company Law Review Steering Group has proposed that objects clauses, in the sense of limits on a company's legal capacity, should be abolished for all other new companies<sup>38</sup>.

5.29 The test of whether an organisation is in the public interest would not be as onerous as the test for charitable status – largely because CICs, unlike charities, would not have tax advantages. It would be more akin to the current test applied at the point of registration to Industrial & Provident Societies for the Benefit of the Community<sup>39</sup>.

### *Accounting*

5.30 Published accounts would be prepared according to a Statement of Recommended Practice formulated by the Accounting Standards Board. It is desirable that this should include a statement on how the organisation was meeting its objects.

### *Insolvency*

5.31 In the event of the insolvency of a CIC, normal company insolvency procedures to protect creditors would apply. During the consultation and implementation phase following the publication of this report, particular attention will be given to determining the rights of preference shareholders in insolvency.

5.32 Views on the idea of a CIC are being sought as part of this review. If, as a result of this consultation, Government is minded to carry the proposal forward, a technical consultation would then follow.

## **Bringing the Industrial & Provident Society up to date**

### *The case for change*

5.33 The I&PS structure is a useful, but under-used and outdated, legal form. Only around 200 are registered each year, compared with around 6,000 charities, over 5,000 companies limited by guarantee (some of which will also be charities), and well over 200,000 companies limited by shares. I&PS legislation has not kept pace with changes to company law. A fundamental overhaul of the structure of the legal form is long overdue.

### *The way forward for the I&PS*

5.34 I&PSs must take one of two forms: societies for the benefit of the community and *bona fide* co-operatives. This reflects the difference between organisations founded on the principles of community benefit and mutual benefit. This is a useful distinction that should be retained, with some amendments to make each form easier to understand and more flexible.

5.35 However, recognition and image are amongst the biggest problems faced by I&PSs, and deter organisations from taking the legal form. Changing the name of the form should give a boost to its recognition and popularity.

<sup>38</sup> Modern Company Law for a Competitive Economy: Final Report, July 2001

<sup>39</sup> Organisations may only register as Societies for the Benefit of the Community where the business is to benefit the community other than its own members, and there are "special reasons" (undefined in law) to register as an Industrial & Provident Society rather than a company under the Companies Acts.

**Recommendations:**

***That the distinction between the bona fide co-operative and the society for the benefit of the community be retained, and that the bona fide co-operative is given a statutory definition in line with the International Co-operative Alliance Statement on the Co-operative Identity;***

***that the names be changed to Co-operatives and Community Benefit Societies, and that the umbrella term Industrial & Provident Society no longer be used; and***

***that Community Benefit Societies be allowed to have distinct categories of members (such as staff and users), but retaining the principle that voting must not be in proportion to capital stake.***

5.36 A further difficulty is that I&PSs currently have no way of protecting their assets against members voting to sell them and split the proceeds (with the exception of those societies which are exempt charities, which fall under normal charity law). In theory, societies for the benefit of the community have such a protection; in practice, though, they can be converted into a company and the assets then sold.

5.37 The thresholds for voting for conversion should be increased. In addition, it would be desirable for I&PSs to choose to protect their assets against any possibility of conversion. In this case, a system would be put in place to ensure that the assets would be transferred to an organisation with similar aims should the society dissolve or be taken over. However, this “lock” on assets will not be appropriate for many I&PSs, and should be optional.

**Recommendations:**

***That the threshold for dissolving or demutualising both Co-operatives and Community Benefit Societies be raised, in line with current rules for building societies; and***

***that Community Benefit Societies also have the option, following a vote of members, to be able to choose to protect their assets in perpetuity for a public purpose and prohibit conversion into a Co-operative or a company.***

5.38 Other changes also need to be made to simplify the use of the form. The £20,000 limit on shareholding by any one member was designed to prevent abuse; however, we believe that the limit is unhelpful for larger societies, and that abuse (such as I&PSs masquerading as deposit-takers) could better be prevented through other means. I&PS legislation should also be kept up to date with company law developments.

**Recommendations:**

***Constraints on financing should be relaxed, and the £20,000 limit on the amount of capital that can be held by any one member removed; and***

***Industrial & Provident Society legislation should be brought up to date with relevant aspects of company legislation (such as on the disqualification of directors), and future updating with company law should be made possible by statutory instrument.***

5.39 Together, these proposals would amount to a fundamental modernisation of the I&PS form, and could revitalise its use amongst both community-level groups and larger organisations. However, they will have far-reaching implications, particularly for existing I&PSs, and will need careful thought. If Government is minded to pursue changes to I&PS legislation following this consultation, then a further, more technical consultation will be held to resolve a number of issues of detail.



## Getting social enterprise recognised

5.40 A lack of understanding of the social enterprise sector, both amongst professionals such as lawyers and bankers and amongst the general public, is a significant barrier to its growth. Updated legal forms may aid recognition, but additional measures would be desirable.

5.41 One way to increase the sector's profile would be for all social enterprises to use a badge or logo, signalling their public purpose – something like the current FairTrade logo. It would be difficult for Government to run such a scheme, not least because the dynamism of the sector would make any administrative rules on granting the status out of date almost before they were written. Sector bodies themselves would be much better placed to build their own system. This would be beneficial in terms of promoting knowledge and understanding.

5.42 It may prove difficult for a brand to be found which would be appropriate for the whole sector. We therefore recommend that preliminary work be done by the sector to see how useful a branding scheme would be, and how it would work.

### **Recommendation:**

***The DTI's Social Enterprise Unit should consult further on the feasibility and value of a branding scheme in order to identify whether there is an option that could be taken forward and supported by Government.***

## A new legal form for charities

### *Difficulties with the current system*

5.43 Many charities currently opt for incorporating as a company limited by guarantee ("CLG") or an Industrial and

Provident Society. However, there are no corporate forms designed to meet the specific needs of charities. This creates a number of difficulties:

- Charitable companies face a burden of dual registration, regulation and reporting between the Charity Commission and Companies House.
- The company corporate governance regime is not tailored to fit the trustee governance structure.
- The role for members of a CLG is based on the underlying assumption of a financial interest in the company, which is not the case for charities.
- Anyone who is a board member of a charitable company is both a company director and a charity trustee. It is unclear exactly how the duties imposed on directors by company law overlap with the duties imposed on trustees by charity law and, where there is a conflict, which takes precedence.
- The CLG is unwieldy for charities in which the directors are the same people as the members since they have to make some decisions in one capacity and other decisions in the other capacity.

### *Creation of a charity-specific legal form*

5.44 The suggestion of a new legal form specifically for charities arose from the Department for Trade and Industry's Company Law Review.<sup>40</sup> The proposal for a Charitable Incorporated Organisation ("CIO") was subsequently developed by an Advisory Group set up by the Charity Commission. The main characteristics of the CIO are described in Box 5.3.

<sup>40</sup> "Modern Company Law: Final Report" para. 4.63 ff. 26 July 2001.



**Recommendation:**  
***That a new legal form designed specifically for charities, the Charitable Incorporated Organisation (CIO), be introduced, which will only be available to charitable organisations.***

\*The paper **Charitable Incorporated Organisation** gives further detail.

5.45 Potential company and European law complications might in the future make it harder for charities to incorporate as a company limited by guarantee. To begin with the CIO

will be an additional legal form for charities, which will continue to be able to incorporate as a CLG instead of a CIO if they want to. Three years after the introduction of the CIO the Government will consider further whether other forms of incorporation should continue to be available for charities.

5.46 The CIO will only apply to England and Wales. Whether a similar vehicle will be introduced in Scotland and Northern Ireland is a matter for those administrations.

### *Box 5.3: Characteristics of the Charitable Incorporated Organisation*

- Incorporated legal form.
- Members' liability limited.
- Foundation and membership formats, so that it is appropriate for charities with and without a membership structure.
- Flexible administrative powers, to reflect the diversity of the sector in terms of size and purpose.
- Model constitutions prepared by co-ordinating bodies, tailor-made for particular parts of the sector.
- Requirement for constitutions to be complete and written in plain English.
- Explicit statement of trustees' duty of care, consistent with the Trustee Act 2000.
- Default provisions for new and existing charities to convert to a CIO by special resolution or by unanimous written resolution.
- Transfer mechanisms to ease conversion from other incorporated forms.

## **6. BUILDING PUBLIC TRUST AND CONFIDENCE AND SUPPORTING THE SECTOR IN IMPROVING PERFORMANCE**

### **Summary**

- There is some evidence to suggest that, in general, charities and other not-for-profit organisations are not producing information which is sufficiently accessible and relevant to the public's needs. Credible comparative information about impact is particularly lacking. This could in the longer term undermine public trust and confidence.
- The largest charities should submit an annual Standard Information Return which would focus on impact and would enable comparisons to be made between similar organisations. Other not-for-profit organisations which fundraise from the public should be encouraged to make available the same information as a matter of good practice.
- Whistle-blowing by an auditor can be a valuable mechanism to guard against abuse of charitable funds. The current statutory protection for auditors of charities which are not companies should be extended to cover auditors of charitable companies.
- Fundraising is the public face of the sector and may have a marked impact on public attitudes. The legislation currently governing public collections is outdated, restrictive and inconsistent and should be replaced by a unified licensing scheme for all public collections covering basic minimum requirements.
- A self-regulatory initiative, based on a new voluntary Code of Practice, should be introduced to promote and raise awareness of good practice in fundraising.
- Although there are many examples of good practice, there has been insufficient focus in the charitable and wider not-for-profit sector as a whole on measuring and improving performance. The use of

**benchmarking, social audit and other quality tools should be encouraged, with Government supporting the appropriate sector-led initiatives.**

- **Current difficulties in recruiting and retaining high quality trustees from diverse backgrounds can undermine effective governance. The principle of voluntary governance for charities should be retained, but charities should be required to state in their Annual Report how they recruit, induct and train trustees.**

This chapter considers:

- information provided by charities and other not-for-profit organisations about their standards, achievements and policies;
- protection for auditors who “whistle-blow”;
- regulation and self-regulation of fundraising;
- performance improvement; and
- measures to encourage trusteeship.

## Promoting public trust

6.1 It is crucially important that public trust and confidence in the charitable and not-for-profit sector should be maintained and if possible increased. A proportion of charities and other not-for-profit organisations rely for their survival on income from fundraising and/or significant input from volunteers. Voluntary income constitutes around 55 per cent of the total for the top 500 fundraising charities<sup>41</sup>. Many charities and other not-for-profit organisations, such as the Samaritans and Citizens Advice Bureaux, operate almost exclusively on the basis of volunteer labour. The health and vitality of

these organisations is, therefore, in large measure determined by public goodwill. Research examining trust and confidence in fundraising charities and other not-for-profit organisations<sup>42</sup> has indicated that, while overall levels of trust are high, the public has concerns about quality of information, accountability and fundraising practice. This in turn can lead people to doubt the probity or the effectiveness of these organisations.

6.2 To some extent all charities and other not-for-profit organisations, regardless of whether they fundraise or involve significant volunteer labour, rely on a good reputation to remain in business. While this is supported by formal charity registration, many organisations have no access to this mark of repute. The public have ever higher expectations of these organisations. This applies both to their ethical practice and to the quality of their service or output. Because charities and other not-for-profit organisations are perceived as value driven, public expectations are likely to be even higher than the norm. This places an onus on these organisations to critically assess their practice and where necessary improve performance.

<sup>41</sup> C. Pharoah and S. Street (2001) *Dimensions 2000: An Update on CAF's Top 500 Fundraising Charities*. London: Charities Aid Foundation.

<sup>42</sup> NCVO (1998) *Blurred Vision*. Research Quarterly 1st January.



## Improving information provision

### *Providing more relevant and accessible information*

6.3 Quality of information is a particular issue for charities and other fundraising organisations. Although registered charities return their report and accounts annually to the Charity Commission, these are inaccessible and often ill-suited to the public's needs. Information about exempt and excepted charities and other not-for-profit organisations can be even more lacking. It is particularly difficult to find credible information about performance or outcomes, and particularly anything which enables meaningful comparison between similar organisations.

6.4 This lack of information means that donors often have little more than individual brands and self-supported claims on which to base their decision to give. In a recent poll, 73% of people said they would be more likely to give to charity if they had independent information about its performance, and 67% said there should be charity league tables<sup>43</sup>. Better information would not only boost public confidence and assist decision-making but could, by focusing attention in this area, strengthen incentives for charities and other not-for-profit organisations to evaluate and improve their performance. In the United States levels of transparency are generally much higher with a range of state and federal bodies such as the Internal Revenue Service, State Attorney General's office and Better Business Bureau playing a role in providing information about charities and other not-for-profit organisations.

### *Compiling comparative information*

6.5 Despite public support for the idea, the Government does not believe that league tables for charities and other not-for-profit organisations are the best way forward. They are only meaningful or useful to the extent that they are based on appropriate indicators of performance which can be applied to all organisations in the table. However, the appropriate indicators for charities, and for the wider not-for-profit sector, have not been sufficiently developed. The difficulty arises because of the diversity of organisations in the sector, and the often unquantifiable nature of their objectives.

6.6 Comparisons of fundraising ratios already exist and have been proposed as the basis for official league tables. However, the fact that fundraising costs vary widely due to factors beyond the charity's control (such as the popularity of the cause, and the proportion of income from legacies and endowments) means that simple ratios without additional explanatory information can be misleading. Moreover, fundraising ratios have the obvious flaw of communicating nothing about the charity's wider performance or outcomes.

6.7 Administration cost ratios also say little about the way in which an organisation is meeting its objectives. They would be potentially more confusing than fundraising ratios because of the divergence between the widely understood concept of administration (any expenditure not going direct to beneficiaries), and the more limited definition of management and administrative costs used in standard charity accounts.

<sup>43</sup> Media Trust (2001) Charity Performance Survey. Press Release 10th October.



6.8 Although it is important for organisations to benchmark themselves against comparable bodies according to a range of financial and other information, comparative information which is geared specifically to the wider public should concentrate on giving a more rounded view of a charity's performance.

### *A new standard of information*

6.9 In the US, comparative information on charities and other not-for-profit organisations is made possible because information contained in the standard forms that they return to the Internal Revenue Service is already in the public domain. Whilst useful as a basis for donor information, these "990 forms" can be time-consuming and onerous for organisations to complete. The need to provide information should be balanced against the costs (especially to charitable funds) of provision. For this reason, whilst all organisations should be encouraged to provide high quality information, only charities, who have a greater degree of public accountability, and then only the largest, should be required to do so. Those charities who have to provide audited accounts (currently those with an annual income or expenditure over £250,000, but Chapter 7 proposes raising the threshold to £1m) should also submit a Standard Information Return to the Charity Commission. This would detail a range of qualitative and quantitative information about the charity, focusing on the charity's impact, how it measures its performance in achieving its aims, and how it intends to improve. This information would then be made available in a user-friendly format on the Charity Commission website.

6.10 Non-charitable not-for-profit organisations which fundraise from the public should be encouraged to make available the same information, for example on their own websites, as a matter of good practice.

6.11 In order to confer some external scrutiny, the information provided should be professionally audited, and where possible should make use of accredited processes (such as use of accredited quality tools). The form should be no more than two sides of A4. An illustration of the type of information which might be included is given in Box 6.1.

#### **Recommendation:**

***As part of their Report and Accounts, the largest charities (those over the proposed new £1m audit threshold – see paragraph 7.42 – 7.44) should complete an annual Standard Information Return. This should highlight key qualitative and quantitative information about the charity, focusing on how it sets objectives and measures its outcomes against these.***

6.12 It would also be desirable if there were greater consistency in the way that charities allocate costs and expenditure, enabling more meaningful financial comparisons to be made. Improvements should also continue to be made to ensure that reports and accounts illuminate achievements against objectives. To this end, recent developments in the Statement of Recommended Practice "Accounting and Reporting by Charities" (the SORP) should be built upon.

#### **Recommendations:**

***The next charity SORP should develop improved methods for apportioning costs and expenditure, enabling more meaningful financial comparisons between organisations to be made.***

***Improvements should continue to be made to the SORP to strengthen its focus on achievements against objectives, organisational impact and future strategy.***





## *Box 6.1: Example of a Standard Information Return*

### **Achievement against objectives**

What were your objectives for last year and how far did you achieve them?

What are your objectives for the coming year and how will you achieve them?

### **Impact**

How do you measure your impact? What are your success measures?

### **Performance Improvement**

Do you use any of the following recognised quality tools? (tick boxes)

Social Audit; Excellence Model; PQASSO; Investors in People; etc.

### **Stakeholder Involvement**

Whom do you see as your main stakeholders? How do you ensure accountability to them? How do you listen to and act on their views?

### **Governance**

How are your trustees selected and equipped for their role?

### **Fundraising**

What fundraising activities do you undertake and why?

Fundraising ratio for the last year together with explanatory text

Fundraising ratio averaged over last five years together with explanatory text

### **Campaigning**

What sort of campaigning work, if any, do you undertake? Are you a member of any campaigning alliances (if so which)?

### **Trading**

Do you own any subsidiary trading companies or are you involved in any significant joint ventures with other organisations (not-for-profit, public or private)? What were their activities, turnover and profits?

### **Reserves and Investment**

What is your investment strategy, including your policy on ethical investment?

What is your reserves policy and what are your reserves currently?

## *Transparency of investment policies*

6.13 Currently, pension fund trustees must disclose their ethical investment stance to their members. However, donors to, or funders of, a charity have no rights to know whether that charity chooses to invest its assets ethically or not – despite the fact that these assets can often be very substantial. Ethical investment is a

matter of some public interest: a recent NOP survey<sup>44</sup> shows that over 40% of the members of the public surveyed would prefer to support charities who invest ethically, while 14% would only support charities which did so. Disclosure about the way in which assets are invested, as well as the size of those assets, should form an important part of the Standard Information Return.

<sup>44</sup> The Guardian Society (2001) The goodness business. 27th June.



6.14 Increased disclosure must also be accompanied by greater clarity over what investment strategies trustees are permitted to follow under charity law. The current position is that trustees can follow an ethical investment strategy – but only if this does not result in significant economic detriment for the charity. Since ethical funds, on average, produce an economic return that is very similar to non-ethical ones, this means that trustees are free to choose from the wide range of ethical funds. This choice should be made clear to them.

**Recommendations:**

***For charities with total annual income of over £1 million, the Charities (Accounts and Reports) Regulations 2000 should be amended in line with the obligations of pension fund trustees to declare their ethical investment stance in their annual reports.***

***Smaller charities which have significant holdings of equities should also make a declaration of their ethical investment stance on a voluntary basis, as a matter of good practice.***

***The ability of charities to follow a broad ethical investment policy should be clarified.***

## Improving accountability

6.15 Lines of accountability in the charitable and not-for-profit sector can be complex. Although organisations are accountable to a range of stakeholders – including beneficiaries, donors, funders, staff, volunteers and the wider sector – practical mechanisms for ensuring these accountabilities are often weak. Charity trustees are accountable in law for the proper use of charitable funds, but this does little to encourage more direct engagement with a range of other stakeholders about the things which matter most to them.

6.16 Many charities and not-for-profit organisations, particularly social enterprises, are using innovative forms of governance to improve their accountability – such as membership or federated structures, user representatives on the board, stakeholder forums, user surveys and social audit approaches. Social audit, whereby an organisation collects testimony from a range of stakeholders about its impact on them, is potentially a very powerful tool both for evaluating performance and as a way of listening to and acting on stakeholder views.

6.17 Although charities are constrained by the need to be governed by trustees who derive no significant private benefit from the charity, this should not stop them using a range of supplementary tools to generate greater involvement by stakeholders.

6.18 For organisations which are not registered charities, the reforms to legal structures outlined in Chapter 5 could encourage the continued use of more innovative forms of governance.

## Preventing fraud

6.19 Public support for charities is encouraged by the perception that stable regulation and monitoring is in place to detect fraud and abuse. The Charity Commission undertakes monitoring of all registered charities with an income or expenditure over £10,000. However, it does not have the resources to look in detail at the operations of every large charity every year. Auditors, who look in detail at large charities financial systems and deployment of funds' are therefore potentially a valuable resource.

6.20 The auditors of registered charities which are not companies have a specific statutory duty to report to the Charity Commission abuse or significant breaches of charity law or



regulation.<sup>45</sup> Auditors who do so have statutory protection from the risk of action for breach of confidence or defamation. Auditors of charitable companies, however, would have to rely on the protection given by case law if they made a similar report in the 'public interest'. Guidance issued by the Auditing Practice Board attempts to address this issue by suggesting that matters of material significance to the regulator can safely be reported in the public interest. However, some auditors remain uncomfortable with this lack of statutory protection. There is a strong likelihood that this ambiguity has inhibited some auditors from reporting serious matters.

**Recommendation:**

**Auditors of all charities should have the same statutory protection from the risk of action for breach of confidence or defamation, as do the auditors of charities which are not companies.**

## Better regulation of fundraising

\* The paper called *The Regulation of Fundraising* provides more detail about these recommendations.

### Fundraising in context

6.21 Fundraising is the public face of much of the charitable and not-for-profit sector, and it is therefore likely to have a marked influence on public attitudes. Surveys indicate that the public do not have a very positive view of fundraising<sup>46</sup>. Competition between charities is viewed with scepticism, and there is perceived to be little information on which to base giving decisions. There is also a view that fundraising is under-regulated, and that there should be greater accountability.

6.22 The fundraising activities of charities and other voluntary organisations are subject to considerable regulation, which falls into two main categories. First, there is sector-specific regulation governing the conduct of public collections, and of raffles and lotteries run for 'charitable, philanthropic and benevolent purposes'. Second, many of the methods used to fundraise, such as direct mail, telemarketing and trading, are subject to generic regulation.

### Better regulation of fundraising

#### Licensing

6.23 The current legislation governing public collections is restrictive and inconsistent. Local authorities have the power (but not the duty) to create licensing schemes for street collections, and can refuse a licence even to a charity which is registered and fully regulated. The legislation is also outdated: for instance, there is uncertainty about whether it covers requests in the street for direct debit commitments, a rapidly growing fundraising method. A new clearer statutory basis for the regulation of all public collections is needed.

6.24 This new system should preserve local authority control over the public nuisance aspects of fundraising (such as too many fundraisers working in a high street) and set basic requirements for the conduct of collections. On top of this, self-regulation, as outlined below, will serve to encourage and promote good practice.

**Recommendation:**

**A new, updated and unified local authority licensing scheme for public collections should be introduced, focusing on basic minimum requirements and geared towards encouraging legitimate collecting activity within the constraints imposed by competition for space and the avoidance of public nuisance.**

<sup>45</sup> The Charities (Accounts and Reports) Regulations 1995 Regulation 6(5).

<sup>46</sup> NCVO (1998) Ibid.



### *Lotteries and gaming*

6.25 The legislation on gaming (including lotteries or raffles) was recently reviewed and some helpful de-regulatory proposals made – for example, about the annual limit on lottery proceeds and ticket price. The Department for Culture, Media and Sport is currently studying the results of a public consultation on this review<sup>47</sup>. The Government's proposals were set out in 'A Safe Bet for Success' in March 2002.

## **Encouraging good practice in fundraising**

### *The need for a body to promote good practice*

6.26 Unifying the licensing system is one step towards better fundraising practice. However, there are other important problems which need addressing, and which will not be solved by changes to the formal regulatory system alone.

6.27 Where fundraising organisations do not comply with the current system, this is largely because of a lack of awareness of their duties rather than deliberate avoidance or abuse. This problem is exacerbated by the fact that a number of regulators are involved in the regulation of fundraising, because of the numerous methods used to fundraise. There would therefore be great benefit in having a single point of contact for information about regulatory requirements for fundraising.

6.28 A body concerned solely with fundraising could also help to address the lack of public awareness and understanding. Many people may have negative attitudes based on media coverage of rare cases of abuse or on hearsay rather than actual experience. There have been few concerted attempts by the sector to counter these negative perceptions and it would be valuable for further work to be done in this area by a new body. Furthermore, a new body could develop an overall Code of Good Fundraising Practice and more specific codes, covering different aspects of fundraising which

go beyond the basic minimum standards set down by law.

### *A self-regulatory basis*

6.29 It was clear from our consultations that fundraising organisations favour self-regulation, in contrast to the public appetite for stronger legal regulation. The Government considers that a self-regulatory scheme which the sector itself helps to set up and run has the best chance of success. This new scheme would build on the valuable work, including work on codes of good practice, already undertaken by organisations such as the Institute of Fundraising and the Public Fundraising Regulatory Association (PFRA).

6.30 However, if self-regulation is not successful, the Home Secretary should have a back-up power to introduce a system of statutory regulation.

### *How it would work*

6.31 The scheme would be voluntary and fundraising organisations would agree to abide by the new body's Code of Good Fundraising Practice. These organisations would be able to use a logo signifying their commitment to good practice. Members of the public would complain to the new body if they considered participating organisations to be in breach. These complaints would be investigated. The sanctions for non-compliance would be naming and shaming, and ultimately expulsion from the scheme.

6.32 The new body should be independent. It should be governed by a board comprising charitable and not-for-profit sector representatives such as fundraisers and umbrella bodies, representatives from Government including the Home Office, and people independent of the sector and Government. This new body should raise fundraising organisations' awareness of the regulations which govern fundraising as a means of improving compliance.

<sup>47</sup> See <http://www.culture.gov.uk>



**Recommendation:**

**Government should support, with seed-corn funding, a new fundraising body to develop the self-regulatory initiative. The body would become self-financing, perhaps by a small levy on donated income, although the method of financing would be a matter for the body itself. This would be based on a new voluntary Code of Practice designed to promote good practice in fundraising, and to raise awareness of the sector's commitment to good practice among the general public.**

**The Home Secretary should be given the power to introduce statutory regulation, which he would exercise if he considers self-regulation to have been ineffective or inadequate.**

### **Transparency about relationships with commercial fundraisers**

6.33 Two main difficulties have been identified in the legislation<sup>48</sup> governing relationships between fundraising organisations and companies engaging in a promotional venture, such as the sale of Christmas cards, for the benefit of a charitable, philanthropic or benevolent purpose. First, the declaration that is required about the extent to which the good cause will benefit from the promotion is not specific enough. The declaration must currently set out in general terms the method by which the benefit is to be determined. Second, the declaration requirement is not enforced. Whilst offences such as this are understandably a low priority for the police, the fact that criminal sanctions exist should itself serve as a deterrent. The Charity Commission should continue to work with charities and the new self-regulatory body for fundraising to raise awareness of the requirements of the legislation. This matters because the public have an interest in transparency and the provision of accurate

information about the nature of a fundraising approach.

**Recommendations:**

**The legislation should be amended to require a specific statement of the return that will be made to charitable, philanthropic and benevolent purposes from promotional ventures.**

**The Home Office should issue guidance, building on that already available, setting out the form of statement appropriate to the particular type of promotion proposed.**

### **Dealing effectively with bogus fundraising**

6.34 The public regard bogus fundraising (people claiming that they are raising money for good causes when in fact they are pocketing some or all of the proceeds) as a particular problem. Though instances of this kind of abuse may be relatively rare it is a risk that can have an effect on public confidence.

6.35 Currently, responsibility for bogus fundraising falls to a number of agencies including, but not restricted to, the police (for investigating allegations of deception or dishonesty or other criminal acts) and the Charity Commission (for ensuring that funds collected for, or in the hands of, charities are properly used). During the consultation for this review concern was expressed that enforcement can be poor because responsibility falls to different bodies. The view was that, although agencies co-operate with each other, they often have different views about the priority to be given to investigations. Effective joint-working is crucial if bogus fundraising is to be tackled effectively. The participation of local police and local authority officers is to be of prime importance since they have a local presence and are likely to be contacted by members of the public concerned that some fundraising

<sup>48</sup> Part II of the Charities Act 1992.



activities may be bogus. The Charity Commission, which has much useful experience and expertise in this area, has been developing its relationship with the Crown Prosecution Service and police and there have been some recent examples of a co-ordinated approach working well.

**Recommendation:**

***The liaison arrangements already in place between the Charity Commission, local authorities and the police should be strengthened by means of protocols setting out agreements on joint working, and other mechanisms.***

## Helping charities and other not-for-profit organisations to improve their performance

### *The challenge of performance improvement*

6.36 Although there are many examples of good practice, there has been insufficient focus throughout the charitable and not-for-profit sector as a whole on measuring and improving organisational performance (defined as the extent to which an organisation meets its aims). There has been under-investment in this area, largely because the benefits of adopting performance improvement tools – such as quality standards – have not always been immediately obvious. Many organisations have implemented these tools only in response to the requirements of funders. In addition, compared with the business sector where the immediate indicators of performance (such as profits and dividend payments) are visible and quantifiable, those in the charitable and not-for-profit sector are not. Finally, the overall regulatory framework for the sector tends to focus on minimum standards rather than good practice, and on processes rather than outcomes.

6.37 A “one size fits all” approach to performance improvement is inappropriate for

such a diverse sector. This is also an area where the sector’s independence is paramount, and Government should aim to facilitate rather than prescribe. Measures outlined in this chapter will have a positive impact on how the sector evaluates and improves its performance.

6.38 The success of the Quality Standards Task Group in explaining the potential benefits of quality standards is in large part responsible for their development and widespread use, particularly amongst charities. An example from the sector is the Community Legal Service Quality Mark scheme. This allows Local Authorities to show support for accredited services, and to link their spending on the voluntary sector to their Best Value Performance Indicators. For tools which are new or still being developed, such as social audit, the sector should develop accredited or recognised processes which organisations can then follow. This will help to ensure that the processes themselves are robust, and that charities provide credible information on the tools they use to the Charity Commission in their Standard Information Returns.

**Recommendation:**

***That Government provides support to the sector for work on performance improvement as part of its wider commitment to build the sector’s capacity. The sector should work collectively to bring forward proposals by April 2003.***

### *Developing benchmarking*

6.39 Organisations in the sector should also be benchmarking their performance against their peers. The Institute for Charity Fundraising Managers and Henley Management Centre are currently piloting a web-based benchmarking initiative for charities that fundraise, with a view to expanding it to cover the top 500 fundraising charities by Autumn 2002. This initiative is welcome, and Government would like to see as many charities as possible participating.



6.40 Given the difficulty of developing universal performance indicators which would be meaningful across the whole sector, benchmarking is particularly appropriate at the sub-sectoral level, where organisations are engaged in similar activities with similar goals. The National Association of Citizens Advice Bureaux, for example, have already developed performance indicators and benchmarking schemes, but more could be done.

**Recommendation:**

***Specific sub-sectors (groups of organisations involved in the same area of service provision) should pilot test an approach to developing common performance indicators and benchmarking for the organisations in their area. If this were to prove successful, it could be used to encourage other sub-sectoral groupings to follow similar approaches. It is not proposed that the Government or the Charity Commission would have a role in the exercise.***

## Measures to encourage trusteeship

6.41 Good governance is crucial to ensuring that organisations are operating effectively. Governance problems can have a profound impact, especially when organisations are forced to dedicate considerable resources to resolving internal disputes. For most organisations, however, governance problems mean that they are less enterprising and less focused on quality improvement than they might be because board members lack the necessary skills, knowledge and expertise. Board recruitment, retention and training are therefore crucially important.

6.42 There is evidence<sup>49</sup> that charities face difficulties in recruiting trustees:

- Small and medium-sized charities particularly seek to recruit younger trustees, but trustees tend to belong to older age groups.
- The amount of time and commitment required for trusteeship sometimes impedes recruitment, suggesting difficulty for those in full-time employment.
- Trustees are personally liable for any loss caused to their charity by a breach of trust on their part. Although personal liability is very rarely enforced against any trustees in practice, the spectre of liability puts people off trusteeship.
- Trustee recruitment is largely informal and based on social networks rather than aptitude, and processes are not sufficiently transparent.
- Many organisations experience tensions between trustees and executive staff.

### *Payment of trustees*

6.43 One of the distinctive features of charities is that their governing boards usually consist of volunteer trustees who, except where specifically authorised, have no financial interest in the charity and receive no benefit from it. Payment for acting as a trustee is not generally permissible, and the consultation suggested that its widespread adoption as a recruitment incentive would be resisted by the sector. In any case, there is little evidence that the promise of payment is an effective general incentive to take on trusteeship.

6.44 A trustee can receive payment or other benefits from their charity if the payment is legally authorised. The legal authority needed is either a clause in the charity's governing document permitting the payment or, if there is no such clause, permission from the Charity Commission. The law allows the Commission to authorise payment to a trustee if the payment is

<sup>49</sup> Charity Commission report and survey (March 2002) of trustee recruitment, selection and induction. NCVO/OU research, reported to this review, found that: 93% of charities still recruit trustees through word of mouth and only 7% had changed their practices during the 1990s; most provided neither "job descriptions" nor induction for new trustees; and 71% of trustees are over the age of 45.



“necessary” to ensure that the charity is properly run, and if it is a “reasonable” amount of money in return for the task done by the trustee.

6.45 During consultations with charities a good deal of continuing support was shown for maintaining the principle of voluntary trusteeship as the basis of charity governance. In particular there was a strong feeling against the payment of trustees for carrying out their duties as trustees. However, many people were in favour of relaxing the rules which prevent a trustee receiving payment for providing the charity with a trade or professional service outside the person’s duties as a trustee. Often a trustee can provide such a service on much more favourable terms than the charity could obtain elsewhere. For instance, a village hall trustee who is a plumber might agree to replace the central heating at cost price; or a trustee who is a solicitor might agree to carry out some conveyancing for a nominal fee. We believe that a trustee should be allowed to be paid for a service if the trustee body, as a whole, reasonably believe it to be in the charity’s interests that the service should be provided by that trustee. The trustee body would of course have to manage the inherent conflict of interest properly, and any transaction for value between a charity and one of its trustees should be conducted openly and reported as required.

6.46 To help maintain the voluntary ethos of much of the sector, the present position should be maintained for payments to trustees which are made purely in their capacity as trustees.

#### *Recruitment of young trustees*

6.47 Trustees tend to belong to older age groups, and there is evidence that small and medium sized organisations in particular have difficulties attracting younger trustees. Although 18 should remain the minimum age for trusteeship, making education about the sector part of the citizenship education component of

the National Curriculum would increase awareness.

#### ***Recommendation:***

***That the citizenship component of the National Curriculum should contain more to encourage learning about, and participation in, charitable and not-for-profit activity, including volunteering and trusteeship.***

#### *Liability*

6.48 Fears about personal liability are compounded by the fact that, at present, only the court can excuse a trustee from liability. The court can do this when it believes that the trustee has acted honestly and reasonably. However, most trustees worried about the consequences of an action they have taken will go to the Charity Commission for reassurance that personal liability will not be enforced against them. The Commission cannot give such an assurance itself since it does not have the court’s power to excuse a trustee. Nor can it say for sure what view the court would come to on the same facts. This leaves trustees uncertain, and in some cases fearful, about their position. Charity trustees should be able to apply to the Charity Commission for relief from personal liability for breach of trust where they have acted honestly and reasonably.

#### ***Recommendations:***

***The SORP should provide for annual reports to include a statement of procedures for recruitment, induction and training of new trustees.***

***A trustee body should have a statutory power to pay an individual trustee to provide a service to a charity (outside their duties as a trustee) if they reasonably believe it to be in the charity’s interests to do so.***

***Charity trustees should be able to apply to the Charity Commission as well as the court for relief from personal liability for breach of trust where they have acted honestly and reasonably.***



## 7. ENSURING INDEPENDENT, OPEN AND PROPORTIONATE REGULATION

### Summary

- In the interests of improved clarity and accountability, the charity regulator (the Charity Commission) should be given a modernised statement of purpose and a new accountability framework based on the following clear strategic objectives:
  - increasing public trust and confidence in charities;
  - ensuring compliance with charity law;
  - enabling and encouraging charities to maximise their social and economic potential; and
  - enhancing accountability to donors and beneficiaries.
- Charities and trustees affected by its decisions should be given new opportunities to challenge these decisions at a reasonable cost, through an authoritative and legally-binding process. There should be a new independent tribunal for this purpose.
- The regulator should continue to have the functions of registration, monitoring, assisting on legal, governance and administrative issues, and investigation. It will also, with sector participation, carry out and publish performance reviews of different sub-sectors.
- The regulator's advisory activities should continue to focus on regulatory and compliance issues. Its information services (including its website) should be developed in line with the needs of donors, users of charity services and other consumers.
- The regulator's independence from day to day political interference is important and should be preserved. Its organisational status should reflect its independence, and its Board should be enlarged to reflect a wider range of stakeholders. A regulator's name should indicate its purpose, so the Charity Commission should be renamed the Charity Regulation Authority.

- **Voluntary activity at grassroots level should not be stifled by regulation. The registration threshold for small charities should be raised and the registration process improved. The overall impact of regulation on charities should be quantified and changes to it monitored over time.**
- **Exempt and excepted charities currently do not have to register and are not accountable as charities. Excepted charities above the new income threshold should be required to register, whilst the existing monitoring regimes for exempt charities should be adapted to cover basic charity law requirements. Those which are currently not monitored should register.**
- **The “gateway” registration procedure should be refined.**

This chapter considers:

- the regulator’s objectives;
- the characteristics, functions and institutional form of the regulator;
- mechanisms for appealing against decisions made by the regulator;
- the regulation of small charities and exempt and excepted charities;
- the impact of regulation on charities; and
- the role of the Attorney General.

## The Regulation of Charities

7.1 The regulation of charities as a specific class of not-for-profit organisation is justified by three factors:

- The basic legal requirement that charities operate for public, not private, benefit.
- The fact that public confidence in charities derives from a knowledge that charities are altruistic in purpose; the perception that the great majority are honestly run and do valuable work in practice; and the belief that

there is regulatory oversight which will identify and deal robustly with misconduct and mismanagement.

- Tax and business rate reliefs.

7.2 The Government believes that continued regulatory oversight of charities as a special class is necessary both to maintain public confidence and to safeguard the interests of taxpayers and other stakeholders. There is a need for regulation of charities to encourage accountabilities to donors and beneficiaries, as accountability in the charity sector can be less direct than that to shareholders and consumers in the private sector. Other not-for-profit organisations do not receive the same tax benefits and do not share such a strong brand as charities. They are often subject to some regulation which applies because of their legal form (for example as a company limited by guarantee) and some which applies because of their activities (such as fundraising or running a care home). Further regulation, along charitable lines, of other types of not-for-profit organisation would risk stifling socially-beneficial activity for little gain.



## Charity Commission objectives

7.3 The Charity Commission regulates charities in England and Wales. It has no direct equivalent in either Scotland or Northern Ireland, though proposals for a similar body in Scotland are under consideration. Recently it has been turning itself into a modern regulator within its current statutory powers and has, rightly, given increasing emphasis to its compliance role, devoting new resources to developing its investigations capability. Using the Internet, it has greatly expanded the range and quality of information publicly available, created an on-line Register of charities and published its internal guidance. It has begun systematically to collect information on customer satisfaction with its own services, which is predominantly favourable, and increased the redress available to dissatisfied customers by making decisions subject to internal review and appointing an independent reviewer for complaints. While acknowledging and welcoming this commitment to change, we believe that the Commission's legal powers and duties and its framework for accountability need to be modernised to allow 21st century needs to be more directly addressed and faster progress to be made.

The Commission currently has a statutory "general function" and a "general object"<sup>50</sup>. These do not, either individually or together, properly describe what objective the Commission exists to achieve, or provide a basis for assessing its performance as regulator.

7.4 A more specific statement of the purposes of charity regulation would help the regulator to present its aims and activities more clearly to charities and the public, and provide a clearer framework of accountability. Like other modern

regulators<sup>51</sup>, the charity regulator should have clear strategic objectives setting out what it exists to achieve. These should be included in the regulator's governing statute since this is properly a matter for Parliament. The statute should require the regulator to work towards these objectives, give it the powers to do so, and set out more clearly than at present how it should report its achievements against them regularly.

7.5 The Commission currently has an overall aim and three strategic objects which, along with linked performance targets, are set out in a Service Delivery Agreement. In 2000/1 it met seven out of its 11 targets.<sup>52</sup> These targets are useful indicators of the Commission's efficiency in processing its business but say little about its impact on the charitable sector. It would be useful to set out the Commission's strategic objectives in its governing statute, supplemented by indicators of its impact on the charitable sector.

7.6 The charity regulator's strategic objectives should be:

- increasing public trust and confidence in charities;
- ensuring compliance with charity law;
- enabling and encouraging charities to maximise their social and economic potential; and
- enhancing accountability to donors and beneficiaries.

### **Recommendation:**

***The charity regulator should have clear strategic objectives in statute setting out what it exists to achieve as regulator.***

<sup>50</sup> S. 1 of the Charities Act 1993. The general function is "promoting the effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matter affecting the charity and by investigating and checking abuses". The general object is "to act in the case of any charity...[so] as best to promote and make effective the work of the charity in meeting the needs designated by its trusts".

<sup>51</sup> Such as the Food Standards Agency and the Financial Services Authority.

<sup>52</sup> See the Commission's annual report for 2000/1. Its performance targets for 2001/2 and beyond are set out in Chapter 9 of the Home Office's Annual Report for 2000/1.

7.7 To ensure the regulator's accountability it will be necessary to develop a set of indicators in these areas which will measure the regulator's impact<sup>53</sup>. The regulator should develop these in consultation with interested parties: the general public, donors, beneficiaries, the charitable sector and the Government. As an example, indicators for the first objective – increasing public trust and confidence in charities – could be linked to survey and other evidence about:

- levels of public confidence in charities;
- levels of public recognition of, and confidence in, the regulator;
- trends in giving, volunteering and other actions that have a correlation with public confidence;
- levels of approval and recognition of the work of charities; and
- perceptions of the amount of fraud in charities compared with the reality.

The regulator's overall performance should be judged by its role in achieving its statutory objectives, as well as the performance targets in its Service Delivery Agreement.

**Recommendation:**

***Indicators should be developed by the regulator, in consultation with interested parties, to allow its performance against its objectives, and its impact on the charitable sector, to be judged.***

## Regulator's characteristics

7.8 In fulfilling its objectives the charity regulator should be:

- accountable;
- independent;
- transparent;

- proportionate, consistent and well-targeted in its regulation; and
- responsive to public views.

These characteristics encompass the five Principles of Good Regulation developed by the Better Regulation Task Force<sup>54</sup>.

## Accountable

### To Parliament

7.9 The regulator is currently accountable to Parliament through:

- its annual report to the Home Secretary, who lays the report before Parliament;
- annual auditing of its accounts by the NAO;
- periodic reports by the NAO on the economy, efficiency and effectiveness with which the Commission uses its resources; and
- periodic examinations by the House of Commons Public Accounts Committee (PAC).

7.10 The Commission's annual report records its service standards and its performance against the standards. The report also details the Commission's future plans. Once the new strategic objectives and indicators are in place, the report should also record the Commission's performance against them.

7.11 Parliamentary reaction to the Commission's annual reports has been consistently low key, and there has rarely been a debate. As a result of this review's recommendations the Commission will be a more open and accountable regulator and should develop a higher public profile. This should in turn encourage greater parliamentary interest. The Government would, for example, welcome the Home Affairs Select Committee taking a regular interest in scrutinising the Commission, the indicators which it has

<sup>53</sup> The Commission is already developing a means of measuring public confidence in the integrity of charity. It will set a target, before March 2003, against which its own contribution to public confidence can be judged.

<sup>54</sup> Published at [www.cabinet-office.gov.uk/regulation/taskforce/index.htm](http://www.cabinet-office.gov.uk/regulation/taskforce/index.htm)



developed to measure its performance, and its performance in relation to those indicators.

**Recommendation:**

**Legislation should require the Commission to report its performance against its objectives in its annual report.**

*To other stakeholders*

7.12 To strengthen its accountability to other stakeholders the Commission should hold an open Annual General Meeting to present its annual report and answer questions. It should also hold regional meetings for the same purpose – a continuation of the regional “Meet the Commissioners” programme of events held in 2001.

**Recommendation:**

**Legislation should require the Charity Commission to hold an open Annual General Meeting at which to present its report and answer questions. It should continue its programme of regional meetings.**

### **Independent**

7.13 The regulator should be independent both of day-to-day political interference and of the charitable sector itself.

7.14 The Charity Commission is, like Customs and Excise and the Inland Revenue, a non-Ministerial Government Department staffed by civil servants. However, only the court can overturn the Commission’s decisions in exercise of its statutory powers. Ministers have no capacity to direct or reverse any of the Commission’s decisions. This insulation from political interests is a strength of the current system and is greatly valued by charities. They see it as a safeguard against charity, and the advantages attached to it, becoming a “political football”.

7.15 Charities also expect their regulator to promote an awareness of charity-specific issues within Government by, for instance, ensuring that policy or proposed legislation in a particular area takes account of any special

considerations applying to charities. Equally, Government should be able to rely on the regulator for an accurate assessment of the potential effects of particular policies on charities.

7.16 The regulator’s relationship with charities should allow it to gain a good understanding of the way charities are run. It would not be able effectively to carry out an advisory role otherwise. But it is crucial that the regulator should remain detached enough to allow it to take strong action against charities where necessary and to avoid “regulatory capture”.

### **Transparent**

7.17 Confidence in the regulator depends on its willingness to explain and justify its decisions to those affected, and to be open about its internal processes.

7.18 During this review many charities acknowledged the Commission’s greater openness in recent years but suggested that it should go further. In particular, charities and their professional advisers seek more information in two areas:

- Commission decisions (particularly on charitable status) that set precedent, exemplify a Commission policy, or are of general relevance to charities.
- How a case progresses through the Commission, and what criteria the Commission uses to make decisions in particular types of case.

7.19 The Commission publishes on the website a short report on each investigation it carries out. It has also begun to publish its staff guidance on particular issues or the conduct of particular types of case. Publication of this guidance is intended to address the second of the two areas mentioned above.

7.20 The Commission has also begun to publish more extensive information about its decisions, as well as the results of internal reviews conducted at Commissioner level of decisions

which have been challenged by charities denied charitable status. The Commission will continue to publish draft and finalised schemes – legal documents altering the constitutions of charities – on its web-site.

7.21 The rules on Open Government and Freedom of Information apply to the Commission.

7.22 Greater openness is to be encouraged. As a further step, the Commission should make available on its website those agendas, papers and minutes for Board meetings which are not exempt from the requirements of open government and Freedom of Information. Its Board meetings should be open, in whole or in part (there will on occasion be reserved business which will not be open), to members of the public to attend as observers, as is the case with other modern regulators such as the Food Standards Agency. The meetings should normally include a question and answer session and should from time-to-time take place in different regions of England and Wales.

**Recommendation:**

***The Charity Commission should open its Board meetings to the general public.***

***Proportionate, consistent and well-targeted***

7.23 The regulator seeks to ensure that charities operate effectively within the law. Its actions in creating, applying and enforcing regulation should take account of:

- charities' capacity to comply with regulation. The capacity of small volunteer-run charities to cope is of a different order to that of large professionally-run charities;
- the nature and level of harm that could result if the events that regulation sought to prevent came about, and the risks of that happening. The Commission has been

developing a risk-based approach to the performance of its major regulatory functions. This aims to identify and manage the risks associated with events that could undermine public confidence in charities<sup>55</sup>;

- the need to treat charities and its other customers even-handedly, and to make decisions which are consistent from one case to the next. During this review some umbrella groups and firms of professional advisers alleged that there is a lack of consistency in decisions between cases which appear to rest on the same or similar facts. The National Audit Office<sup>56</sup> also pointed to differences in the internal procedures different offices followed for dealing with registration case-work. Despite the concerns expressed to us, however, the percentage of customers describing the Commission's services as very or fairly good for clarity, speed and comprehensiveness, is in the mid 80s for most services;
- the impact its actions, and the overall "poise" it adopts as regulator, have on its credibility with different groups of stakeholders, who have different and sometimes conflicting expectations. For instance, the confidence of some stakeholders might depend on the regulator exercising a high degree of routine oversight of charities. Others might view that as heavy-handed and likely to deter people from voluntary involvement in charities.

***Responsive to public views***

7.24 The Charity Commission currently has a relatively low public profile. Only one in seven of the public can name the Commission as the charity regulator. Its level of recognition is well below that of, for example, the Law Society and the Consumers' Association<sup>57</sup>. Its publications and website are targeted fairly narrowly at charity trustees, staff and professional advisers.

<sup>55</sup> Published on the Commission's web-site at [www.charity-commission.gov.uk/tcc/riskframe.asp](http://www.charity-commission.gov.uk/tcc/riskframe.asp)

<sup>56</sup> NAO (2001). Giving Confidently.

<sup>57</sup> MORI/Charity Commission (1999).



Apart from the register of charities, there is little information available from the Commission aimed at members of the public in their capacity as donors, volunteers, beneficiaries and consumers.

7.25 To promote public confidence in charities, and to manage public expectations about itself, the regulator should publicise its role, activities and achievements. There is evidence<sup>58</sup> of some public misunderstanding about the issues that Commission can and cannot investigate within charities. The Commission has a publication explaining the types of complaint it can look into, which is routinely provided to members of the public who complain to it about charities, but the Commission should further clarify its policies on the use of its powers of intervention and give them greater public prominence.

7.26 Many of the regulators examined in the course of this review – such as the Financial Services Authority, the Health and Safety Executive and others – consider it central to their role to provide information to the consumer about the constituency they regulate. This approach could be useful in the charity sector. At the very least the Commission could use its website as a gateway to other sources of information.

**Recommendation:**

***The Charity Commission should develop a better focus on the needs of stakeholders other than the regulated constituency by:***

- ***providing advice on giving aimed at potential donors;***
- ***making standard information about the largest charities available on its web-site (see Chapter 6); and***
- ***signposting on its website other appropriate bodies that members of the public should contact if they wish to complain about a particular aspect of a charity's work or mode of conduct.***

## Regulator's functions

7.27 The charity regulator needs to be equipped with appropriate functions and powers to achieve its objectives. The Charity Commission already has statutory powers in four principal areas:

- The registration of charities.
- Annual monitoring of the financial and other affairs of larger charities.
- Assistance on legal, governance and administrative issues to help charities run themselves more efficiently (which the Commission calls "Charity Support").
- The investigation of mismanagement and misconduct within charities.

Each of these is examined below.

## Registration of charities

7.28 The register of charities is available on the Commission's web-site<sup>59</sup>. During 2001, 5,900 new charities were added, giving a total of 188,000 at the year-end. The register:

- is the only record of organisations which have been officially accepted as being for the public benefit and which, therefore, receive privileged tax treatment;
- allows charities to give conclusive proof of their status to funders and others;
- gives members of the public up to date information about charities, individually or in groups, and access to the people running them;
- allows the regulator to monitor charities and their affairs on an annual basis;
- allows people running charities, or thinking of starting new ones, to identify others carrying out similar work;

<sup>58</sup> In the report on the Commission by the Independent Complaints Reviewer (November 2001).

<sup>59</sup> At [www.charity-commission.gov.uk/registeredcharities/default.asp](http://www.charity-commission.gov.uk/registeredcharities/default.asp)

- gives local authorities, umbrella bodies and special interest groups an overall view of the size and scope of charitable provision in their sphere of interest; and
- provides policy-makers and researchers with evidence about the economic weight of the charitable sector and the distribution of wealth within it.

*The “gateway” procedure for registration*

7.29 The Charity Commission is required to register any institution which is a charity (unless it is exempted or exempt).

7.30 The procedure for applying for registration as a charity, the “gateway”, requires applicants to provide, in addition to their constitutional documents, a range of information about their actual or proposed activities, plans for funding and trading, and trustees.

7.31 The Commission has been criticised for the “gateway” procedure in the charity press, and by some charities, umbrella bodies and lawyers in submissions to this review. The main criticisms are that the Commission:

- takes into account the viability of an organisation when deciding whether or not to register it. Some critics argue that the Commission is not legally entitled to do this; and
- applies an “activities test” by looking at an applicant’s actual or proposed activities as an aid to interpreting the purposes stated in the applicant’s constitution. Some critics believe that the Commission is not entitled to apply an activities test when the applicant’s purposes are clearly charitable, but say that it does so in all cases. Most admit, however, that the law is unclear as to exactly when an activities test can be applied.

7.32 In the year the “gateway” was fully introduced (1999/2000), the proportion of applicants who succeeded in registering fell to 64% from a high of 92% in 1997/8. In 2000/1 it rose to 73%. Some critics have used this as

evidence that the Commission is aiming to make it more difficult for charities to register when (they say) it should be doing the opposite in order to encourage grassroots voluntary activity. The “gateway” can also be onerous for very small organisations.

7.33 Through the “gateway” procedure the Commission seeks to ensure that new charities meet basic standards of governance and have a workable constitution. It argues that this is part of its duty as a regulator, and is in line with public expectations. It feels that the criticism of the gateway procedure is not justified. It says that, when deciding whether or not to register an organisation, it only considers whether the organisation is legally charitable. Its view is that it is legally entitled to apply an activities test:

- where the stated objects of the organisation are not clear;
- even if the stated objects are clear, where there are doubts about whether any of the tests of public benefit will be satisfied when the objects are pursued; or
- where the organisation may be a “sham”.

7.34 These are the circumstances in which the Commission says it considers activities, or intended activities, in the registration process. It believes it has a clear legal basis for doing so, although it acknowledges that some have expressed doubts about this.

7.35 If the organisation is a charity, the Commission recognises that it has a duty to register it. But having decided that an organisation is a charity, the Commission is quite properly also concerned about its viability and the adequacy of its governance arrangements, and it is entitled to pursue these concerns whether the organisation has yet been registered or not.

7.36 The “gateway” process was developed in response to suggestions from the Public Accounts Committee that greater scrutiny of charities was required at the point of registration.





7.37 While viability and governance are issues of public confidence which it is legitimate to address, the “gateway” procedure does leave room for confusion between two processes which should be kept distinct:

- Judgement as to whether or not an applicant is legally a charity.
- Assessment of the applicant’s viability as an organisation.

7.38 The information needed for each process should be sought in a way which clearly indicates the purpose for which it is being sought. If an organisation is legally a charity it should be registered promptly then given assistance and/or monitored to ensure it operates properly.

**Recommendations:**

***The Commission should seek to separate the process of judging whether or not an applicant is a charity from that of assessing viability.***

***The circumstances in which an “activities test” can be used as an aid to interpreting purposes should be clarified in statute<sup>60</sup>.***

### **Annual Monitoring**

7.39 Monitoring contributes to public confidence in charities and encourages proper governance within charities. Statutory power to monitor charities, by a compulsory annual return, was given to the Charity Commission in 1996, when the relevant Charities Act 1993 provision came into force.

7.40 The annual monitoring system makes greater demands on charities, and subjects them to greater scrutiny, as their size, and the risk of harm that could result from their failure, increases. Around 50,000 charities – those with an income or expenditure over £10,000 – are monitored annually.

7.41 The statutory accounting, reporting and auditing requirements are similarly graduated.

#### *Audit threshold for medium-sized and larger charities*

7.42 A charity which is not a company must have its accounts for a particular financial year professionally audited (i.e. audited by a person registered as an auditor under the Companies Act 1989) if either:

- its gross income or total expenditure exceeded £250,000 in that financial year; or
- its gross income or total expenditure exceeded £250,000 in either of the two years preceding that financial year.

7.43 A charity which is a company must have its accounts for a particular financial year professionally audited if its gross income is over £250,000 in that year.

7.44 These rules are unnecessarily complicated and impose a professional audit requirement at too low a level. The charity threshold should be raised to £1 million. Below that level (down to an income threshold of £10,000) charities should continue to be required to have their accounts examined by a competent independent person. Additional safeguards already exist: for example, for some charities a professional audit is a constitutional requirement.

**Recommendation:**

***That all charities with income of £1m or more in any financial year should be required to have their accounts for that year professionally audited. The independent examination requirement should apply to charities with income between £10,000 and £1m. The latter threshold should be re-examined if the audit threshold for non-charitable small companies changes.***

<sup>60</sup> A clause attempting this was dropped from the Bill that became the Charities Act 1992.

## *Assistance on legal, governance and administrative issues*

7.45 This function, which the Charity Commission calls “Charity Support”, consists of modernising the purposes, governance and administrative arrangements in charities’ constitutions, advising on legal and regulatory requirements, and authorising actions and transactions which charities would not otherwise have the legal power to carry out. In 2000/1 the Commission handled 36,700 separate “charity support” cases.<sup>61</sup>

7.46 Amendments to the Commission’s powers in these areas with a view to making changes easier and quicker have already been considered in Chapter 4.

### *Combining regulation and advice*

7.47 Most of the Commission’s powers are directed towards ensuring that charities meet their legal obligations and operate for their proper purposes. However, it is also part of the Commission’s function to give charity trustees “information and advice on any matter affecting the charity”. This clearly allows the Commission not only to tell charities what their legal obligations are, but also to adopt a wider advisory role on good practice. The Commission on the Future of the Voluntary Sector<sup>62</sup>, an independent review, examined the tensions that have sometimes arisen out of this “dual role” of regulator and adviser. It concluded that:

- there were good reasons for the Charity Commission to have an advisory as well as a regulatory role; and
- it should do more in its communications with charities to distinguish between matters of law and matters of good practice.

7.48 The Government believes that both of these conclusions still hold good. Many other

regulators successfully combine the dual role; and some add a third element to their role, serving consumers. The Commission has made progress – particularly in its publications – in the second area. However, testimony to this review suggests that the blurring of boundaries between the Commission’s advisory and regulatory roles continue to cause confusion among charities and other key stakeholders.

7.49 The Commission’s primary function is, and should be, a regulatory one; and the bulk of its resources are rightly dedicated to this function. Nor does the Commission have the resources to sustain an advisory capacity as extensive as the statutory phrasing – “information and advice on any matter” affecting a charity – suggests. It should retain an advisory role but this should be more precisely defined and focused on the issues over which it has regulatory responsibility.

### **Recommendation:**

***The Charity Commission’s advisory role should be defined in statute to give a clearer focus on regulatory issues.***

## *Investigation and enforcement*

7.50 The regulator’s capacity to investigate and check abuse within charities is its most widely understood function and addresses most directly the concerns that the public have about charities. It is crucial to public confidence.

7.51 The Commission has a statutory power to investigate any registered or excepted charity. It also has powers to:

- protect charity assets at risk; and
- take action against those responsible for misconduct or mismanagement in a charity.

7.52 In 2000/1 the Commission concluded 212 investigations in which some “cause for concern” was established.

<sup>61</sup> NAO (2001).

<sup>62</sup> Deakin Commission (1996).



7.53 There are a number of criminal offences in charity law, designed to ensure compliance with important obligations and to penalise those who fall down on their obligations. In many cases the consent of the Director of Public Prosecutions is needed before proceedings can be taken in many cases.

7.55 The four functions above, and the Commission's powers in those areas, are necessary for it to meet its new objectives and should be retained.

### ***Charity Commission role in maximising social and economic potential***

7.56 The Charity Commission already has a general function of promoting the effective use of charitable resources. It takes forward that duty using the statutory powers described above. The recommendations made so far in this chapter aim to improve the clarity, appropriateness and effectiveness with which it uses its powers. Most of the current regulatory focus is on the internal operation of the charity in relation to its objects, in isolation from the sectoral environment within which those charities operate. It is important that the regulator also takes a wider view of charitable objects and the beneficiaries which they serve.

7.57 To further its objective of maximising the economic and social potential of the sector the Charity Commission should undertake a rolling programme of reviews of performance in particular areas of charitable provision. These might focus for example on particular charitable sub-sectors (e.g. homelessness or children's services) or on charitable provision in a geographical locality. There should be sector participation in the scoping and steering of the studies to ensure that reports focus on areas where they are most needed and are carried

out in a way which is most useful. The reports, which would seek to give a broad, factual overview and highlight key issues of interest to charities and their stakeholders, would build on the Commission's existing programme of thematic regulatory reports. They would be particularly valuable where a particular distribution of resources in a given field may be failing, albeit unintentionally, to serve the interests of beneficiaries and the underlying charitable objects most effectively. An example of this might be where there are too many charities serving a particular group of beneficiaries, resulting perhaps in duplication of effort and waste, or where a reconsideration of priorities might be helpful. Such examples are rare, and the Government's view is that having a large number of charities is, in general, a good thing. But in certain sub-sectors there can be too many players and beneficiaries can suffer.

7.58 The Commission would not and must not interfere in the independent governance of charities. But it does have a duty to promote the efficiency and effectiveness of the sector and to ensure that charitable objects are being served most effectively. The Charity Commission would not have any new intervention powers, but rather would serve to enhance knowledge and make available adequate information for the benefit of trustees, funders, beneficiaries and donors, by publishing factual reports.

***Recommendation:***  
***The Charity Commission should review, with sector participation, and report on the performance of different charitable sub-sectors with a view to correcting information failures and enabling stakeholders to maximise beneficiaries' interests and better fulfil underlying charitable objects.***



## Regulator's funding, form and status

7.59 The Charity Commission is funded from taxpayers' funds. Unlike some other registrars or regulators – such as Companies House and the Registrar of Friendly Societies (now part of the Financial Services Authority) – the Commission does not charge for any of its regulatory services to charities. There are special sensitivities about imposing regulatory charges on charities. The Government believes that the regulator should continue to be funded from public funds. However, there should be scope for charging for discretionary services or products such as training events and some publications.

7.60 The regulator should be free to adopt its own corporate planning arrangements, set its own operational priorities and to negotiate its own settlement with the Treasury. This is the Commission's position at present. In return it should remain accountable to Parliament as described above.

7.61 The Commission's current status as a Government Department (although a non-Ministerial one) gives it an insider's access to the processes of Government. This helps to ensure that the concerns of charities are heard by Government. However, that status has led some to question the Commission's capacity and will to operate independently of governmental influence. Others are confused about the nature of the Commission's relationship with Government. Ideally, the regulator should have access to Government without being seen as part of it.

7.62 The Commission is not currently a corporate body. The functions and powers commonly described as those of "the Commission" are in fact functions and powers of the five Charity Commissioners personally. This might have been appropriate some time ago when a far greater proportion of the Commission's decisions were made, or directly

supervised, by individual Commissioners; but today it is merely confusing.

7.63 The regulator's name should succinctly explain its purpose. The Government proposes the 'Charity Regulation Authority'.

### **Recommendation:**

***The charity regulator should continue to operate at arms length from Ministers. It should become a statutory corporation called the Charity Regulation Authority, whose relationship with Ministers is clearly defined in statute.***

### **Governance**

7.64 There are currently five Charity Commissioners, which is the maximum number currently allowed by statute. Two of the Commissioners must be lawyers. The Commissioners are appointed by the Home Secretary and are responsible for the exercise of the Commission's statutory powers and functions and for its governance. Three Directors join the Commissioners to form the Commission's board. A small board such as this has the advantage of manageability and ease of decision-making, but is open to the accusation that it is narrowly focused and that the interests of some groups of stakeholders are not fully represented in its discussions.

7.65 We therefore recommend that the board of the Charity Commission should be expanded by adding four new Commissioners. One Commissioner should be appointed by the Secretary of State for Wales and the remainder by the Home Secretary. Appointments should achieve wider representation of voluntary sector and other stakeholder interests.

7.66 The Chief Commissioner is currently both Chair and Chief Executive of the Commission, and its Accounting Officer. A second Commissioner has an executive role as head of the Commission's legal division. The other three Commissioners are non-executives. With the proposed increase in the number of



Commissioners, and the higher public profile that the Commission is to adopt, there is a strong case for introducing separate Chair and Chief Executive posts. The Chair's particular role would be in ensuring good corporate governance and the smooth functioning of the enlarged board, and in representing the Commission in public and at high level within Government and the charitable sector. A majority of Commissioners would be non-executive. To maintain flexibility, the number of board members should be variable by Order.

**Recommendation:**

**Legislation should enable the number of Commissioners to be increased from five to nine, with one Commissioner appointed by the Secretary of State for Wales. There should be separate Chair and Chief Executive posts.**

## Devolved administrations

7.67 Although the Charity Commission has jurisdiction over England and Wales, all three of its offices are in England. Opening a separate office in Wales would enable the Commission to develop a greater awareness of the local and regional issues affecting Welsh charities, and to provide a service better attuned to their needs.

7.68 It is explicitly part of the UK Government's approach to encourage relationships to develop between the devolved administrations and their respective voluntary sectors that reflect local priorities and conditions. However, there would be much to be gained from sharing information and best practice among the various UK charity regulators, ensuring consistency of regulatory approaches, and co-operating on cross-border issues wherever possible. To this end a new UK umbrella committee should be created. This would not be a governing body, but a forum for information exchange and co-operation.

**Recommendations:**

- **The Charity Commission should open an office in Wales.**

- **A new umbrella committee, on which all UK charity regulators are represented, should be created, to ensure a consistent regulatory approach UK-wide and to share information and best practice.**

## Appeals against regulator's decisions

### Complaint and review systems

7.69 The Charity Commission has introduced a complaint system and a review system. The complaint system allows people dissatisfied with the Commission's conduct or service to lodge a formal complaint. This begins as an internal process but, if the complaint is not resolved that way, it passes to the Independent Complaints Reviewer, whose role is similar to that of an external ombudsman.

7.70 The review system allows people dissatisfied with a decision that the Commission has made in exercising its statutory powers to ask for the decision to be reviewed. This is a process with several stages that could go up to Board level within the Commission, but ends there. It can take considerable time to go through the process, which has no external or independent element.

### The importance of a right of independent appeal

7.71 Even with a clearer framework for charitable status, there will be disputed cases in which a body refused charitable status will want to mount a legal challenge to that decision. There will also be cases in which a person affected by a decision (for example, to remove the person from trusteeship of a charity) will want to challenge it.

7.72 Currently the only right of appeal to an independent authority against a decision of the Charity Commission is to the High Court. In practice this right is rarely exercised. There is a widespread perception that appeals necessitate

undue expense and delay, and that the Commission is virtually unchallengeable in practice. This may deter significant numbers of charities and individuals with at least arguable grounds for appeal from taking this course.

7.73 It is already important that the Commission's decisions should be, in both fact and appearance, open to challenge. It will become even more important as two particular initiatives progress.

7.74 The first is the Commission's Review of the Register, which looks at the status of classes of organisation defined by their purposes. This process aims to ensure that the definition of charity keeps pace with developments in society. Although it has brought a number of new purposes into the charitable domain, it is just as capable of concluding that whole classes of charity are no longer charitable and should be removed from the register. Many rifle and pistol shooting clubs have already been removed in this way.

7.75 The second is the systematic review we recommend (paragraph 4.26 onwards above) into the public character of some types of charity, such as those which charge high fees. This could conclude that some charities do not provide public benefits on a large enough scale to justify their charitable status. Again, this could ultimately lead to decisions to remove individual organisations from the register.

### *A new appeals system*

7.76 The Government believes, therefore, that an independent tribunal should be introduced to hear appeals against Commission decisions. A person or organisation affected by a decision will have an automatic right of appeal and will be able to represent themselves.

7.77 This will bring the Commission's procedure into line with, for example, the Financial Services Authority, the War Pensions Agency, Customs and Excise, and the Inland

Revenue, all of which have an independent review before court action is necessary.

7.78 The recent Leggatt report<sup>63</sup> recommended that all tribunals should be brought together in a single service and should operate consistently. Leggatt proposed that tribunals should have two tiers but allowed exceptions for a few tribunals which are so expert that their cases go on appeal direct to the Court of Appeal. Under current governance arrangements for tribunals, it might be appropriate to follow the Copyright Tribunal model for appeals against the Charity Commission – where appeals from the tribunal go to the High Court because some expertise on charity law resides there. This would be a single first tier tribunal, consisting of a mixture of lay people and legal experts where appropriate for the case in question. Tribunal members would be appointed by the Lord Chancellor by open competition to ensure unchallengeable independence. The Charity Commission would be the respondent. The tribunal's role will be in relation to legal decisions but not case-handling decisions, which will continue to be covered by the complaints procedure described in paragraph 7.69 above. In the event of the inclusion of the Charity Commission tribunal in the Tribunals Service, consideration will need to be given to whether, and how, this proposed single tier and case-handling process is brought in to line with the remainder of the Tribunals Service. This process will seek views concerning the role of the Attorney General in the appeals process.

7.79 Alongside this, the Commission's internal decision-review procedure (described in paragraph 7.70 above) should be streamlined to a single stage. An automatic right of appeal should also be introduced.

#### **Recommendation:**

***An independent tribunal should be introduced to hear appeals against the legal decisions of the Commission as registrar and regulator. This will be introduced alongside***

<sup>63</sup> Sir Andrew Leggatt (2001). *Tribunals for Users, One System, One Service*.



***a streamlined single stage internal review procedure.***

7.80 The tribunal should also be available in cases where no decision has been made but where the decision-making process has been excessively long or an impasse has been reached. The applicant should be able to ask the Commission for a determination of their case if the Commission has been working on the case for a specified period of time without reaching a decision, and may then take this decision to the tribunal.

## Rules on registration

### *Small charities*

7.81 Most small charities operate at a local or community level, though some are associated with or are subsidiaries of national charities. A few employ part-time workers, but the majority are run by their unpaid trustees or committee members, sometimes with help from other volunteers. They are the grassroots of charity. By and large they present the least regulatory risk, and have limited capacity to cope with regulation.

7.82 At present, any charity with an annual income of £1,000 or more must register with the Charity Commission, unless it is excepted or exempt by law (see paragraph 2.24). Charities with an income of less than £1,000, but who hold a permanent endowment or have use or occupation of land, must also register. And charities that are not required by law to register may do so voluntarily. There are about 42,000 registered charities with an income of £1,000 or below.

7.83 The consultation undertaken for this review suggested that some organisations find the registration process time consuming, opaque and costly. In 2000/1 about 2,200 applications to register (27%) failed. Little research has been carried out into what

happens to organisations whose applications fail and it may be that organisations are being unnecessarily dissuaded from undertaking voluntary activities. The Charity Commission understandably needs to make checks to ensure that organisations seeking registration are legally charitable. But the process can be onerous for small groups who are unused to dealing with bureaucracies, have little knowledge of charity law, and cannot afford professional advice.

7.84 Some smaller organisations register voluntarily because it provides a badge of credibility. A charity registration number implies ongoing monitoring. However, active monitoring only applies to those charities with an annual income or expenditure of more than £10,000. The public and funders may be drawing false comfort in relation to smaller charities which are registered but are not actively monitored by the Charity Commission. A £10,000 threshold for registration, which will also involve ongoing monitoring, would be more meaningful.

***Recommendation:***

***The threshold for compulsory registration should be raised to £10,000. The two criteria relating to permanent endowment and use/occupation of land should no longer apply***

7.85 Charities with income under £10,000 which are no longer registered will still be:

- required to send a copy of their latest accounts to anyone who asks; and
- subject to the Charity Commission's information and investigation powers. This means that, at random or in response to specific concerns or complaints, the Commission could require them to submit accounts or to provide other information about their affairs. The Commission could also open a statutory investigation and take action to deal with mismanagement.

### *A new status for small charities*

7.86 It is proposed that the provision for voluntary registration for charities with incomes below the new threshold will not be continued. This means that these charities would no longer be allowed to register. It is recognised that some charities value their registered status and would like to retain it. It acts as a mark of official recognition, helps them access funding, and gives them credibility in their external dealings more generally. These concerns have not been overlooked:

- Charities below the new threshold for registration will be permitted to use the new status of “Small Charity”.
- Releasing Small Charities from registration would not mean that they inevitably went “off the radar”, since umbrella and representative bodies for groups of Small Charities would be free to compile their own lists or registers (as some already do). Local authorities have had powers since 1960 to keep a public index of charities in their area. Official recognition will be available, as in Scotland and Northern Ireland, for those organisations making claims for tax relief from the Inland Revenue, whose registration process is simpler than the Charity Commission’s. This in turn will encourage take up of tax efficient giving.
- Most small charities attract support through local accountability, not through the simple presence of a charity registration number. Such accountability is to be encouraged – a central regulator is never going to be able to devote significant resources to monitoring the very smallest cases, and donors and others need to be encouraged to develop more meaningful accountability checks.
- Legislative changes will take some time and there will therefore be a reasonable lead in time to help umbrella bodies and the organisations themselves to plan for change.
- This could be used as an occasion to help encourage many of those small organisations to grow and for other bodies to help raise the profile of smaller bodies.
- New small charities will be freed from what many consider an onerous registration process.
- New bodies will often be able to use model constitutions from a variety of sources to ensure that their objects are charitable.
- Funders will have provision to enable them to fund small charities. There are some funders who as a matter of law, or of their own policy, are restricted to making grants only to registered charities. The law will be changed to remove this legal restriction. A policy to restrict funding to registered charities would be wrong in principle as it would exclude a large number of organisations on grounds which are nothing to do with their capacity to convert funding into useful outcomes.

### **Recommendations:**

***All charities below the new registration threshold should have the status of “Small Charity”. They would not be entitled to register as charities, but those that made tax repayment claims would have acceptance from the Inland Revenue of their charitable status – as is already the case for unregistered charities in England and Wales, and for all charities in Scotland and Northern Ireland.***

***There should also be a change in the law to enable funders who are legally limited to funding registered charities also to fund “Small Charities”.***

7.87 The income of some charities could fluctuate above and below £10,000 from year to year. Provision would have to be made so that charities were not required to register, deregister, reregister and so on in successive years.





7.88 These measures would release over 90,000 existing charities from the need to remain registered. About 35-40% of applications to register (of which there were 8,200 in 2000/1) are from organisations with actual or anticipated income below £10,000. Around 3,000 organisations a year would be released from the duty to apply for registration, though they would have to apply later if their annual income reached £10,000.

#### ***Exempt and excepted charities***

7.89 In order to promote trust and confidence in the regulatory system as a whole it is important that all organisations with charitable status should be subject to the same accountability requirements. However, a large number of charities – exempt and excepted charities – are currently not required to register with the Charity Commission. They do not have to submit reports and accounts and are not monitored by the Commission although they enjoy the same tax reliefs and recognition as other charities. Allowing these organisations to avoid regulation as charities creates anomalies, is confusing for the public, and threatens the integrity of the status.

#### *Exempt charities*

7.90 Many charities, including some religious charities, scouts and guides and armed forces groups, were excused from registration with the Charity Commission in the 1960s, when the Commission exercised no regular oversight of charities. These are “excepted” charities. These organisations were not required to register with the Commission because they were registered with their own umbrella or support groups. In the context of today’s more extensive reporting and monitoring regime for registered charities, designed to improve accountability for charitable funds, these exceptions no longer make sense. However, a new higher threshold for those charities, of perhaps £50,000 annual income, should be set to ensure that the process is manageable and focuses on the largest charities.

7.91 Exceptions are also regarded as offering privileged treatment to some charities and are open to the challenge of unfairness. In particular, the religious denominations with “excepted” status are all Christian. This is unlikely to be compatible with the Human Rights Act 1998.

#### ***Recommendation:***

***Excepted charities with incomes above the new proposed registration threshold (discussed in paragraph 7.81 onwards) should be required to register. A higher registration threshold could be set to ensure a manageable process of registration.***

7.92 A number of these charities, such as many churches, will be able to register on a group basis because they form part of a church hierarchy.

#### *Exempt charities*

7.93 Another group of charities, including universities, housing associations and charitable industrial and provident societies, have not been allowed to register with the Charity Commission on the basis that they are ‘adequately supervised by another regulator’. These are exempt charities.

7.94 Exempt charities that are regulated on the basis that they receive significant public funds, such as universities and housing associations, are not being monitored in relation to charity law requirements. This review found that some of these organisations were unaware of the requirements of charity regarding, for example, governance arrangements and stewardship of funds. This potentially lays these organisations open to challenge since, like all other charities, they are required to abide by charity law principles. We propose that the ‘main regulators’ of these bodies should assess compliance with charity law as part of their usual monitoring processes. The aim would be to introduce the requirement with a light touch, using existing forms and reporting mechanisms, so as to minimise any additional regulatory burden.



7.95 The Charity Commission already has the power to give advice to exempt charities on their responsibilities in relation to charity law and regulation. In addition, it will provide advice and support to ‘main regulators’ in the drafting of guidance on charitable status for their constituencies. ‘Main regulators’ will have responsibility for ensuring compliance with charitable status but could ask the Commission to investigate if they had concerns about abuse of charitable funds.

7.96 Some exempt charities have no “main regulator” at all – for example those charitable Industrial and Provident Societies which are not regulated by the Housing Corporation. There have been concerns, in the absence of regulatory oversight, about misuse of funds. These organisations should be required to register with the Charity Commission.

**Recommendations:**

***The monitoring regimes to which housing associations, universities and colleges as exempt organisations are subject should be adapted to cover basic charity law requirements.***

***The reports and accounts of exempt charities should clearly set out the voluntary funds they hold and how they use them. The same level of information about exempt charities as is required of charities should be made accessible on or via the Charity Commission web-site.***

***The Charity Commission should be given a power to investigate exempt organisations on the request of their ‘main regulator’.***

***Larger exempt charities, without a ‘main regulator’ should be registered with the Charity Commission.***

*Implementing the changes*

7.97 Registering a large number of charities, even allowing the increase in the threshold for registration (see paragraph 7.83), will entail significant work for the regulator. It will also have the task of working with other regulators to ensure that basic charity law requirements are met by exempt charities.

7.98 To ease the burden of implementation on the regulator and the charities concerned, the new arrangements should be introduced gradually, with the threshold for registration for formerly excepted and exempt organisations set higher than an annual income of £10,000, perhaps at £50,000 annual income. It is estimated that around 5,000 of the largest excepted and exempt organisations will be affected.

## The impact of regulation

7.99 One of the concerns most frequently raised with the review by charities and other not-for-profit organisations was the overall impact of regulation – the combination of rules and compliance obligations they face as a result of their legal status, legal form and activities.

7.100 Charities and other not-for-profit organisations are especially likely to perceive regulation as burdensome if:

- they are not consulted when the regulation is being created;
- no adequate guidance on compliance is given by the body creating or enforcing the regulation; or
- organisations believe the regulation is disproportionate to the risk it addresses.

7.101 All Government Departments creating regulations must prepare Regulatory Impact Assessments (RIAs). The National Audit Office recommended<sup>64</sup> that the Cabinet Office should

<sup>64</sup> NAO (2001). In Better Regulation: Making Good Use of Regulatory Impact Assessments.



consider producing guidance for departments on how to take the specific interests of charities and other not-for-profit organisations into account when preparing RIAs. The Government endorses the NAO's recommendation.

**Recommendation:**

***The Charity Commission, with advice from the Cabinet Office's Regulatory Impact Unit, should quantify the impact of regulation on charities and other not-for-profit organisations, monitor it over time, publish the results and highlight areas where regulation appears excessive.***

## Role of the Attorney General

7.102 The Attorney General acts on behalf of the Crown as protector of the public or charitable interest. The Charity Commission and the Attorney General have concurrent responsibility in some areas – for example in authorising ex gratia payments (i.e. payments made under a moral obligation but without any legal power). The Commission exercises its responsibility in respect of some of its powers under the Attorney's supervision.

7.103 The current Attorney General, Rt Hon Lord Goldsmith QC, and the Solicitor General, Rt Hon Harriet Harman QC, (the Law Officers) took up office in June 2001. Since then they have been reviewing the work of the Attorney General in his capacity as protector of charity.

7.104 The Law Officers consider that the Attorney General's role in this area is not always well understood within the sector and that it is very much in the public interest that it be continued and strengthened through greater transparency.

7.105 The Law Officers have put in place arrangements for closer working relationships with the Charity Commission, including the development of criteria identifying in what circumstances the Attorney General is likely to consent<sup>65</sup> to the Commission taking legal proceedings.

7.106 The Law Officers are also committed to being more open about the Attorney General's work as protector of charity. They plan to publish information about their charities work in their Annual Report (which they plan to produce for the first time). The Attorney General so plans to hold a seminar on aspects of charity law and regulation, involving the Commission, charity law practitioners and other stakeholders.

<sup>65</sup> Under s. 32 of the Charities Act 1993.

## 8. IMPLEMENTATION

### Summary

- A re-focused Active Communities Unit (ACU) will play a central role in developing, broadening and co-ordinating the Government's strategic approach to the charitable and not-for-profit sector.
- Some of the recommendations in this report require changes in primary legislation whilst others involve changes in Government policy or administrative practice. The programme of implementation will be managed by the ACU in conjunction with other Departments and agencies as appropriate.
- The Home Secretary has responsibility for charity law in England and Wales. Following the consultation period for this report, the ACU will publish a detailed timetable for the preparation of legislation. Reform of Industrial & Provident Societies is likely to require separate legislation.
- The ACU will publish a Paper next year setting out the Government's next steps and strategy for the sector.

This chapter considers:

- a new approach toward the sector in Whitehall;
- the legislative programme; and
- evaluation of the impact of the measures in the Review.

### The role of the sector

8.1 Whilst there have been some promising attempts at self-regulation (including fundraising, accreditation and quality standards) very often these have failed to win sufficient sector-wide support or impetus. An

understandable reluctance to adopt imperfect initiatives has, on occasion, led not to their subsequent development and introduction, but to resistance to change and maintenance of the status quo.

8.2 An effective framework for the future growth and success of the sector depends in part on the role played by the sector itself, and in particular the key umbrella and other infrastructure organisations. Whilst the sector's diversity is a strength, this should not inhibit it from speaking with a common voice on important issues and tackling collaboratively issues of sector-wide importance, such as fundraising, mergers and joint working.



## The role of Government: a new approach in Whitehall

8.3 There is also some scope for Government to improve its current approach. The Home Office's Active Community Unit (ACU) has been restructured and refocused, and it will play a central role in developing and broadening the Government's strategic approach to the sector, drawing together the various strands of policy and co-ordinating the Government's approach.

8.4 This will place the ACU's previous volunteering and active citizenship focus within a more comprehensive strategy towards the whole sector. This would involve supporting and sponsoring all parts of the sector, from small community groups through to large charities.

8.5 Government also recognises the need to put more consistently into practice the principles of partnership, and to modernise and improve its funding practice. Although progress is being made, implementation of the Compact on Relations between the Government and the Voluntary and Community Sector in England (November 1998) to date has been patchy; and there is a need to raise awareness of the principles it sets out, both in the sector and in Whitehall. In addition, government funding practice has sometimes been inconsistent, bureaucratic and inflexible, imposing an unnecessarily onerous burden on voluntary organisations. The findings of the Regional Co-ordination Unit's study of regeneration funding, and of the Cross-Cutting Review of public service delivery by the voluntary sector, will both do much to tackle this problem.

8.6 The ACU will also ensure that Government Departments meet their responsibilities under the Compact, and in the Codes of Practice established under the Compact. (In Wales there is a statutory Voluntary Sector Scheme dealing with the same issues as the Compact in England.)

8.7 A key theme of this report is the development of social enterprise. Evidence of

the Government's commitment in this area was the creation in October 2001, within the Department of Trade and Industry, of the Social Enterprise Unit. The Unit's role is to promote a greater understanding among policy-makers, and those responsible for shaping and delivering services, of the role that social enterprises can play. The Unit will also act as a champion for the social enterprise sector and a source of advice and information on it.

8.8 Some of the recommendations in this report can only be implemented through primary legislation. Others can be achieved through changes in Government policy or by administrative action. The ACU will be managing the programme of implementation and will ensure that other Departments and public authorities are in a position to make the contributions required of them at the right time. It will also be working closely with the devolved administrations in Wales, Scotland and Northern Ireland.

8.9 The ACU will publish a Paper next year setting out the Government's next steps and strategy for the sector as a whole. It will also set out an implementation plan for the recommendations arising from this report.

## Legislation

8.10 The Home Secretary has responsibility for charity law in England and Wales. It is intended that the recommendations needing legislation will be included in a Home Office Bill. In the meantime, following the consultation period for this report, the ACU will publish a more detailed timetable for the preparation of legislation, including the possibility of publishing a draft beforehand for technical comment if time allows. Any reform of Industrial and Provident Societies is likely to require separate legislation.

8.11 There have been recent reviews of charity law both in Scotland (the McFadden report) and in Northern Ireland. In each case any legislation will be for the devolved administration to prepare.

## ANNEX 1. THE PROJECT TEAM, SPONSOR MINISTER AND ADVISORY GROUP

The report was prepared by a team drawn from the public and private sectors, and advised by a Ministerial Sponsor and an Advisory Group.

### 1. The Team

- Ben Aslet – from the Strategy Unit Central Team
- Vicki Bakhshi – seconded from the Financial Times
- Margaret Bolton – seconded from the National Council for Voluntary Organisations
- Rachel Buxton – research placement
- Richard Corden – seconded from the Charity Commission
- Ruth Ingamells – from the Strategy Unit Central team
- Katie Law – from the Strategy Unit Central Team
- Thea Longley – seconded from Bates, Wells and Braithwaite Solicitors
- Simon Morys – seconded from Inland Revenue
- Simon Strickland – from the Strategy Unit Central Team

### 2. Sponsor Minister

- All Strategy Unit project teams' work is overseen by a sponsor Minister with an interest in the subject area. The original sponsor Minister for this project was Baroness Sally Morgan, but from December 2001 it was David Blunkett, Home Secretary.

### 3. Advisory Group

- In addition, the team was advised by an Advisory Group, chaired by the sponsor Minister, comprising:
  - Jonathan Bland – Social Enterprise London
  - Stuart Etherington – National Council for Voluntary Organisations
  - Judith Hill – Farrers & Co. (Solicitors)
  - Gabriel Chanan – Community Development Foundation
  - Mike Emmerich – No. 10 Policy Directorate
  - John Stoker – Charity Commission
  - Helen Edwards – Home Office
  - Geraldine Peacock – Guide Dogs for the Blind
  - Maeve Sherlock – HM Treasury
  - Daleep Mukarji – Christian Aid
  - Robert Baldwin – London School of Economics
  - Jamie Rentoul – Strategy Unit
- The team gratefully acknowledges the advice and time given by the Advisory Group.

### 4. Workshop Attendees

- The team was also greatly assisted by being able to draw on the experience and advice of a number of experts who attended a series of seminars, workshops and panel discussions associated with the project. A full list of these events, and of the attendees, is available on request from the Strategy Unit.

## ANNEX 2. SUMMARY OF RECOMMENDATIONS

In the following list of recommendations, those printed in bold will require legislative change; other recommendations may be implemented without legislation.

- 1. That charity be redefined in law, based on the principle of public benefit and falling under one of ten new purposes of charity. (4.18)**
2. The Charity Commission should undertake on-going checks on the public character of charities. (4.30)
- 3. To amend charity law to allow charities to undertake all trading within the charity, without the need for a trading company. The power to undertake trade would be subject to a specific statutory duty of care. (4.47)**
4. That the Charity Commission guidelines on campaigning should be revised so that the tone is less cautionary and puts greater emphasis on the campaigning and other non-party political activities that charities can undertake. The legal position should continue to be that charities can campaign providing that:
  - a charity's activities are a means to fulfilling its charitable purpose;
  - there is a reasonable expectation that the activities will further the purposes of the charity and benefit its beneficiaries, to an extent justified by the resources devoted to those activities;
  - its activities are based on reasoned argument; and
  - its activities are not illegal.
- The Charity Commission should distinguish between this position, which is statement of legal and regulatory requirements, and good practice. It may wish to publish advice on good practice, but in doing so should emphasise that trustees have the freedom to pursue whatever activities they judge to be in the best interests of the charity. (4.56)
5. That the Charity Commission should provide specific advice to facilitate mergers, possibly by creating a dedicated internal unit. (4.62)
- 6. That a package of legal measures should be introduced that will facilitate mergers and, more generally, the administrative running of the charity. (4.62)**
7. **Criteria for allowing trustees to spend capital should be revised. (4.68)**
- 8. That a Community Interest Company be established, with the characteristics set out in Box 5.2. (5.21)**
- 9. That the distinction between the *bona fide* co-operative and the society for the benefit of the community be retained, and that the *bona fide* co-operative is given a statutory definition in line with the International Co-operative Alliance Statement on the Co-operative Identity (5.35)**
- 10. That the names be changed to Co-operatives and Community Benefit Societies, and that the umbrella term Industrial & Provident Society no longer be used. (5.35)**
11. That Community Benefit Societies be allowed to have distinct categories of



members (such as staff and users), but retaining the principle that voting must not be in proportion to capital stake. (5.35)

- 12. That the threshold for dissolving or demutualising both Co-operatives and Community Benefit Societies be raised, in line with current rules for building societies. (5.37)**
- 13. That Community Benefit Societies also have the option, following a vote of members, to be able to choose to protect their assets in perpetuity for a public purpose and prohibit conversion into a Co-operative or a company. (5.37)**
- 14. Constraints on financing should be relaxed, and the £20,000 limit on the amount of capital that can be held by any one member removed. (5.38)**
- 15. Industrial & Provident Society legislation should be brought up to date with relevant aspects of company legislation (such as on the disqualification of directors), and future updating with company law should be made possible by statutory instrument. (5.38)**
16. The DTI's Social Enterprise Unit should consult further on the feasibility and value of a branding scheme in order to identify whether there is an option that could be taken forward and supported by Government. (5.42)
- 17. That a new legal form designed specifically for charities, the Charitable Incorporated Organisation (CIO), be introduced, which will only be available to charitable organisations. (5.44)**
18. As part of their Report and Accounts, the largest charities (those over the proposed new £1m audit threshold – see paragraph 7.42-7.44) should complete an annual Standard Information Return. This should highlight key qualitative and quantitative information about the charity, focusing on how it sets objectives and measures its outcomes against these. (6.11)
19. The next charity SORP should develop improved methods for apportioning costs and expenditure, enabling more meaningful financial comparisons between organisations to be made. (6.12)
20. Improvements should continue to be made to the SORP to strengthen its focus on achievements against objectives, organisational impact and future strategy. (6.12)
- 21. For charities with total annual income of over £1 million, the Charities (Accounts and Reports) Regulations 2000 should be amended in line with the obligations of pension fund trustees to declare their ethical investment stance in their annual reports. (6.14)**
22. Smaller charities which have significant holdings of equities should also make a declaration of their ethical investment stance on a voluntary basis, as a matter of good practice. (6.14)
23. The ability of charities to follow a broad ethical investment policy should be clarified. (6.14)
- 24. Auditors of all charities should have the same statutory protection from the risk of action for breach of confidence or defamation, as do the auditors of charities which are not companies. (6.20)**
25. A new, updated and unified local authority licensing scheme for public collections should be introduced, focusing on basic minimum requirements and geared towards encouraging legitimate collecting activity within the constraints imposed by competition for space and the avoidance of public nuisance. (6.24)
26. Government should support, with seed-corn funding, a new fundraising body to develop the self-regulatory initiative. The





- body would become self-financing, perhaps by a small levy on donated income, although the method of financing would be a matter for the body itself. This would be based on a new voluntary Code of Practice designed to promote good practice in fundraising, and to raise awareness of the sector's commitment to good practice among the general public. (6.32)
- 27. The Home Secretary should be given the power to introduce statutory regulation, which he would exercise if he considers self-regulation to have been ineffective or inadequate. (6.32)**
- 28. The legislation should be amended to require a specific statement of the return that will be made to charitable, philanthropic and benevolent purposes from promotional ventures. (6.33)**
29. The Home Office should issue guidance, building on that already available, setting out the form of statement appropriate to the particular type of promotion proposed. (6.33)
30. The liaison arrangements already in place between the Charity Commission, local authorities and the police should be strengthened by means of protocols setting out agreements on joint working. (6.35)
31. That Government provides support to the sector for work on performance improvement as part of its wider commitment to build the sector's capacity. The sector should work collectively to bring forward proposals by April 2003. (6.38)
32. Specific sub-sectors (groups of organisations involved in the same area of service provision) should pilot test an approach to developing common performance indicators and benchmarking for the organisations in their area. If this were to prove successful, it could be used to encourage other sub-sectoral groupings to follow similar approaches. It is not proposed that the Government or the Charity Commission would have a role in the exercise. (6.40)
33. That the citizenship component of the National Curriculum should contain more to encourage learning about, and participation in, charitable and not-for-profit activity, including volunteering and trusteeship. (6.47)
34. The SORP should provide for annual reports to include a statement of procedures for recruitment, induction and training of new trustees. (6.48)
- 35. A trustee body should have a statutory power to pay an individual trustee to provide a service to a charity (outside their duties as a trustee) if they reasonably believe it to be in the charity's interests to do so. (6.48)**
- 36. Charity trustees should be able to apply to the Charity Commission as well as the court for relief from personal liability for breach of trust where they have acted honestly and reasonably. (6.48)**
- 37. The charity regulator should have clear strategic objectives in statute setting out what it exists to achieve as regulator. (7.6)**
38. Indicators should be developed by the regulator, in consultation with interested parties, to allow its performance against its objectives, and its impact on the charitable sector, to be judged. (7.7)
- 39. Legislation should require the Commission to report its performance against its objectives in its annual report. (7.11)**
- 40. Legislation should require the Charity Commission to hold an open Annual General Meeting at which to present its report and answer questions. It should**



**continue its programme of regional meetings. (7.12)**

41. The Charity Commission should open its Board meetings to the general public. (7.22)
42. The Charity Commission should develop a better focus on the needs of stakeholders other than the regulated constituency by:
  - providing advice on giving aimed at potential donors;
  - making standard information about the largest charities available on its web-site (see Chapter 6); and
  - signposting on its website other appropriate bodies that members of the public should contact if they wish to complain about a particular aspect of a charity's work or mode of conduct. (7.26)
43. The Commission should seek to separate the process of judging whether or not an applicant is a charity from that of assessing viability. (7.38)
44. The circumstances in which an "activities test" can be used as an aid to interpreting purposes should be clarified in statute. (7.38)
45. That all charities with income of £1m or more in any financial year should be required to have their accounts for that year professionally audited. The independent examination requirement should apply to charities with income between £10,000 and £1m. The latter threshold should be re-examined if the audit threshold for non-charitable small companies changes. (7.44)
46. The Charity Commission's advisory role should be defined in statute to give a clearer focus on regulatory issues. (7.49)
47. The Charity Commission should review, with sector participation, and report on the performance of different charitable sub-sectors with a view to correcting information failures and enabling stakeholders to maximise beneficiaries' interests and better fulfil underlying charitable objects. (7.58)
48. **The charity regulator should continue to operate at arms length from Ministers. It should become a statutory corporation called the Charity Regulation Authority, whose relationship with Ministers is clearly defined in statute. (7.63)**
49. **Legislation should enable the number of Commissioners to be increased from five to nine, with one Commissioner appointed by the Secretary of State for Wales. There should be separate Chair and Chief Executive posts. (7.66)**
50. The Charity Commission should open an office in Wales. (7.68)
51. A new umbrella committee, on which all UK charity regulators are represented, should be created, to ensure a consistent regulatory approach UK-wide and to share information and best practice. (7.68)
52. **An independent tribunal should be introduced to hear appeals against the legal decisions of the Commission as registrar and regulator. This will be introduced alongside a streamlined single stage internal review procedure. (7.79)**
53. **The threshold for compulsory registration should be raised to £10,000. The two criteria relating to permanent endowment and use/occupation of land should no longer apply. (7.84)**
54. **All charities below the new registration threshold should have the status of "Small Charity". They would not be**



**entitled to register as charities, but those that made tax repayment claims would have acceptance from the Inland Revenue of their charitable status – as is already the case for unregistered charities in England and Wales, and for all charities in Scotland and Northern Ireland. (7.86)**

**55. There should also be a change in the law to enable funders who are legally limited to funding registered charities also to fund “Small Charities”. (7.86)**

**56. Excepted charities with incomes above the new proposed registration threshold (discussed in paragraph 7.81 onwards) should be required to register. A higher registration threshold could be set to ensure a manageable process of registration. (7.91)**

**57. The monitoring regimes to which housing associations, universities and colleges as exempt organisations are subject should be adapted to cover basic charity law requirements. (7.96)**

**58. The reports and accounts of exempt charities should clearly set out the voluntary funds they hold and how they use them.**

The same level of information about exempt charities as is required of charities should be made accessible on or via the Charity Commission web-site. (7.96)

**59. The Charity Commission should be given a power to investigate exempt organisations on the request of their ‘main regulator’. (7.96)**

**60. Larger exempt charities without a ‘main regulator’ should be registered with the Charity Commission. (7.96)**

**61. The Charity Commission, with advice from the Cabinet Office’s Regulatory Impact Unit, should quantify the impact of regulation on charities and other not-for-profit organisations, monitor it over time, publish the results and highlight areas where regulation appears excessive. (7.101)**



Strategy Unit  
Cabinet Office  
Fourth Floor  
Admiralty Arch  
The Mall  
London SW1A 2WH  
Telephone 020 7276 1416  
Fax 020 7276 1407  
E-mail [strategy@cabinet-office.x.gsi.gov.uk](mailto:strategy@cabinet-office.x.gsi.gov.uk)

© Crown copyright 2002

Publication date September 2002

**This report is printed on Revive Matt material. It is made from 75% recycled de-inked post-consumer waste, is totally chlorine free and fully recyclable.**

The text in this document may be reproduced free of charge in any format or media without requiring specific permission. This is subject to the material not being used in a derogatory manner or in a misleading context. The source of the material must be acknowledged as Crown copyright and the title of the document must be included when being reproduced as part of another publication or service.