

DIRECTORY OF SOCIAL CHANGE

INFORMATION AND TRAINING FOR THE VOLUNTARY SECTOR

DSC Response to the Review of the Charities Act 2006

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About the Directory of Social Change

The Directory of Social Change has a vision of an independent voluntary sector at the heart of social change. We believe that the activities of charities and other voluntary organisations are crucial to the health of our society.

Through our publications, courses and conferences, we come in contact with thousands of organisations each year. The majority are small to medium-sized, rely on volunteers and are constantly struggling to maintain and improve the services they provide.

We are not a membership body. Our public commentary and the policy positions we take are based on clear principles, and are informed by the contact we have with these organisations. We also undertake campaigns on issues that affect them or which evolve out of our research.

We view our role as that of a 'concerned citizen', acting as a champion on behalf of the voluntary sector in its widest sense. We ask critical questions, challenge the prevailing view, and try to promote debate on issues we consider to be important.

DSC's principle of Responsible Regulation

DSC's interest in charity law and regulation is both principled and practical. For example, we have organised the annual Charity Law conference with the law firm Bates Wells Braithwaite for the past 21 years, to help charities gain a practical understanding of their regulatory and legal environment. But our views are grounded in clear principles.

We believe that voluntary activity should be regulated responsibly. Some regulation is necessary to safeguard and maintain the interests of the general public, the beneficiary, and of the organisations and individuals being regulated. However, it should have a demonstrable benefit and should aim to empower and strengthen voluntary activity rather than control it unnecessarily.

We believe that:

- a) **Regulation should be proportionate** – it must strike a balance between perceived risk and intended benefit. It should recognise the diversity of voluntary sector activity and be developed and applied in a proportionate way.
- b) **Regulation should be appropriate** – it must be informed by the characteristics, capacity, and needs of the organisations and individuals that are being regulated. Insofar as is possible it should be focussed, rather than acting as a blunt instrument that has unintended effects.
- c) **Regulation should be enabling** – it should seek to empower rather than control voluntary activity. The reasons for the regulation and the regulation itself must be properly understood by those institutions which are applying it. It should be accessible and intelligible to those being regulated. It should seek as far as possible to encourage self-regulation rather than focus simply on enforcement.

1. Summary of key points

For the benefit of the reader we summarise below our key points in response to this review. These points are repeated at the conclusion of each section which follows.

- 1) Government should reconsider its financial settlement for the Charity Commission. If this is impossible, Government should find a way to fund continued access to free help and advice for smaller charities about relevant law and regulation.
- 2) The results of the online surveys carried out as part of this consultation should be treated with caution. Questions 7, 8, 23-25, and 33 in particular should be ruled out of scope. At a minimum the number of responses and the number of abandoned surveys should be published along with any results and analysis.
- 3) No further legal or regulatory reforms should be made that would allow trustees to be paid for their duties as trustees.
- 4) The Charity Commission's legal status should remain unchanged. A comprehensive register of charities must be maintained by the Charity Commission. Charities should not be charged to be included in the register. The Review should explore how Trustees Annual Reports could be improved.
- 5) The significant downsides and risks of a 'sub-regulator' approach need to be fully considered in any reform, particularly the potential impact on the integrity of the register of charities.
- 6) Further reforms to the law and regulation around public benefit should not be attempted at this time. The Commission and charities need to focus on addressing the question of public benefit as determined in the 2006 Act and the outcome of the Upper Tribunal case.
- 7) The Review should explore whether further simplification of reporting thresholds could benefit charities, the public and the Charity Commission.
- 8) We would recommend further targeted consultation with small charities and their representative bodies, specifically on the issue of voluntary registration below £5000 income, and whether the current regime acts as a barrier to the development of such charities.
- 9) Any reform in the guise of 'social investment' which allowed investors to influence or control charitable activity would not be in the public interest. Regulatory changes which could potentially affect all charities should not be made on the basis of a narrow interest group or a particular Government's policy agenda.
- 10) The Charity Commission should not refuse to register charities on the basis of supposed 'duplication' or grounds of 'efficiency'. However, the Review could usefully investigate the way the Commission signposts prospective new charities towards organisations already in existence which do similar work – including philanthropists who wish to set up foundations. The question of winding up or transferring the assets of grant making trusts which are no longer able to act within their objects also should be examined further.

2. Reflections on the current state of charity law and regulation

In the current policy environment for charities, the need for enabling regulation – or informed self-regulation – is arguably greater now than ever.

The biggest factor defining current debate is the Government's short-sighted decision to drastically cut the budget of the Charity Commission. Although the savings are paltry in terms of overall government spending, they are massive in terms of the Charity Commission's budget and the ability of hundreds of thousands of charity trustees to ensure their organisations conduct their affairs within the law.

Crucially, the cuts also threaten to undermine public trust and confidence in charity, as the Commission will simply have far less resource available to ensure charities are operating properly. Decisions taken in the name of short-term efficiency are likely to have long-term negative consequences.

We would urge the Government, even at this late stage, to reverse the cuts to the Commission's budget, because the level of cuts calls into question the capacity of the Commission to act as an effective regulator of the charity sector in the future. They have necessitated a radical programme of 'reform' and change management, where questions that were previously beyond the pale are being seriously asked – including within the current review. For example:

- The possibility of the Charity Commission ceasing to be a public body, accountable to Parliament, and turning it into some kind of charity trade association instead
- The possibility of whole classes of charities being put beyond the scope of the Commission's direct regulation, and compromising the integrity of the register of charities
- The possibility that rules against paying charity trustees to be trustees will be abandoned or significantly relaxed – which would threaten public confidence in charity and even the very concept of charity
- The possibility that the register of charities – surely a key part of effective self-regulation in the future – will become less comprehensive and not sufficiently maintained
- The likelihood that in future charities will have to pay for their own regulation
- The likelihood that it will become harder for citizens to register a charity, which will act as a brake on voluntarism and civic action
- The certainty that telephone help and advice for charity trustees will be drastically cut (which, ironically, will also make self-regulation less effective)

None of these things is in the wider public interest; nor are they in the interest of charities themselves, the beneficiaries they help, or of charity donors and supporters.

The system of charity regulation in Britain is complicated but robust in comparison to that of many other countries. Surely existing charity law is in need of some rationalisation and updating in some specific areas. However, the charity brand and the registered charity number underpin the trust that the public has in charity – and the financial and other support charities receive flows from that trust.

Reform should aim first and foremost to preserve and improve that trust, rather than to hollow out the foundations on which it is based in the name of 'efficiency' or 'deregulation'.

Key Point – Government should reconsider its financial settlement for the Charity Commission. If this is impossible, Government should find a way to fund continued access to free help and advice for smaller charities about relevant law and regulation.

3. The current review of the 2006 Charities Act

This review covers a wide range of issues, including detailed and technical matters of charity law and regulation, as well as big-picture questions. We appreciate that Lord Hodgson has called for ‘real world examples’ and hope that many charities will provide these from their own experience. At this stage DSC is able to offer high level feedback rather than detailed specifics, but we would welcome more detailed discussions as the review progresses.

3.1 Process and outcomes of the review

Whilst the current review is an opportunity for reform, we have concerns about the process over the longer-term. Namely, what policy capacity in government and what Parliamentary time will be available to address the eventual recommendations, and how those will be realistically carried forward into meaningful changes which improve the regulatory environment for charities?

Given the serious constraints on the Charity Commission’s resources, combined with the significant organisational change it is currently undergoing, we would urge a realistic and practical approach.

3.2 Methodological problems with online surveys

We think the two surveys linked to this review on the Cabinet Office website – one for charities and one for ‘the public’ – are problematic for a number of reasons. In particular:

- Many of the survey questions are inherently flawed, making the answers of no value. A good example is question 33, which explains what the FRSB is then asks the respondent whether he or she has heard of the FRSB. There can only be one logical response – ‘yes’.
- Many of the questions are leading in their phrasing and progression, which is likely to bias the response. For example question 7, which begins with ‘*Some people think that there are too many charities, and that this results in duplication and inefficiency*’. The subliminal invitation is to agree with ‘some people’.

Added to this, there are a number of wider problems with the surveys as a research exercise:

- For both surveys, there is no way of determining whether any response pool is a representative sample of ‘the public’ or of ‘charities’, respectively; and in both cases is extremely unlikely to be so.
- We doubt the response rate will be high, increasing the risk that subsequent policy will be made on the basis of an extremely small and unrepresentative sample.

We fully appreciate that constructing research surveys which produce sound evidence can be a difficult exercise – more so when the topic is very specialist and technical. This is all the more reason for expecting a higher standard of methodological rigour.

Key Point – Because of these methodological problems, the results of the online surveys be treated with caution. Questions 7, 8, 23-25, and 33 in particular should be ruled out of scope. At a minimum the number of responses and the number of abandoned surveys should be published along with any results and analysis.

3.3 Calls for evidence

In addition to the online surveys, the review includes calls for evidence in the following areas:

- Charity Commission
- Public benefit and the definition of charity
- Exempt charities and the principal regulator approach
- Land disposals
- Trustees
- Mixed motive investment
- Merger, restructuring and winding up
- Organisational forms
- Public charitable collections
- Fundraising: self-regulation and transparency
- Charities' accounting and reporting
- Charity registration and excepted charities
- Complaints, appeals and redress

Below we make comments in response to a number of these areas. We have included information from DSC's standing policy positions and some responses to previous consultations where relevant.

4. The role of trustees

The consultation raises a number of questions about trustees, including whether they should be allowed to be paid for performing their role.

DSC is adamantly opposed to any move to allow trustees to be paid for performing their duties, and we believe this is the sentiment of the vast majority of charities and charity trustees. We do not object to trustees being reimbursed for expenses, but we believe that trustees should serve voluntarily, and that when they are paid for services rendered to the charity this also can lead to conflicts of interest.

In our view, voluntary trusteeship is a fundamental principle of what charity means. If it is altered significantly we think this would threaten public trust and confidence in charity. The fact that even if a charity employs staff they serve at the behest of volunteers is a crucial factor in maintaining the distinctiveness of what it means to be a charity.

It might seem that relaxing rules on paying trustees would be deregulatory and therefore 'enabling' for charities to make their own decisions. On the contrary, we believe that degrading

the clear principle that trustees should serve voluntarily would lead to a confusing and uncertain situation for boards and individual charity trustees, which would not enable them to make decisions in the best interests of the organisation and its beneficiaries.

Most arguments in favour of paying trustees seem to be based on the idea that payment inherently improves trustee performance, retention and recruitment. We think this is wrong and that in fact it is better to have individuals governing charities who have no financial interest in the organisation. In general, introducing payment is likely to increase, not reduce, difficulties with governance.

Key Point – no further legal or regulatory reforms should be made that would allow trustees to be paid for their duties as trustees.

5. The Charity Commission

5.1 Status and role of the Charity Commission

The consultation floats the idea that the Charity Commission's status as a non-Ministerial Government Department could change in the future. We believe the Commission should remain as it is. Changing it significantly at this time would not be desirable or practicable. The Charity Commission needs to remain a government department with the authority of a formal regulator, which is independent of direct Ministerial control.

As the call for evidence suggests, even prior to the current cuts the Commission has arguably never been able to rigorously regulate every charity – or even to assess all the accounts submitted.

In an environment of reduced resources, the only way forward is to rely even more heavily on self-regulation, but with the Commission continuing to play a central role in retaining and providing information, both for charities and the public, allowing it to prioritise its enforcement action in the areas of greatest risk. Enabling self-regulation will depend on (at least) two key elements:

- 1) An increased focus on providing transparent, meaningful, comprehensive and current information about charities to the public
- 2) Continued access to authoritative help and advice directly from the regulator for charity trustees

Neither of these elements on their own would necessarily produce a cost saving for the Commission, or would necessarily be considered 'deregulatory'. They would need to be prioritised against other activities. To be effective, they would require:

- 1) Maintaining the integrity of the register of charities – especially the information on the Charity Commission's website – ensuring the register is comprehensive and up to date
- 2) Somehow resourcing help and advice for the vast majority of charities which will not be able to afford or inclined to seek professional advice, if this becomes less available from the Commission

- 3) Improving the information required in charity reports and accounts, to make it more meaningful for the general public, whilst making it easier for charities to produce. For example, working to improve the quality of Trustees' Annual Reports.

5.2 DSC's response to the Charity Commission's Strategic Review

In our response to the Commission's review in 2011, we said its top priorities should be:

- 1) *Retaining and enhancing the public register, using transparency to promote self-regulation and public accountability – continuing to research / gather data to inform the general public, and public policy about charities*
- 2) *Prioritising support for trusteeship and governance in the Commission's public information and the help and advice it offers, ensuring this remains accessible for small trustee-led charities*
- 3) *Not charging for advice, information or registration – particularly for small charities which cannot afford to pay, as this would be:
 - a. *A disincentive to the civic activism charities represent, which the Government and many others want to encourage*
 - b. *Subsidising public spending cuts with charitable funds*
 - c. *Creating a different set of 'consumer expectations' of the Commission, or a different kind of transactional relationship (what kind of service am I getting for my fee?)**
- 4) *Not putting in place barriers to registration which have the main purpose of reducing the register or the number of charities, in order to reduce costs*
- 5) *Where possible, work with Government to identify areas of regulation that could be simplified or removed*

Key Point – The Charity Commission's legal status should remain unchanged. A comprehensive register of charities must be maintained by the Charity Commission. Charities should not be charged to be included in the register. The review should explore how Trustees Annual Reports could be improved.

5.3 A 'sub-regulator' approach

As part of the consultation, a 'sub-regulator' approach has been suggested. This would mean that certain classes or types of charities, or those which were members of certain membership organisations, would be regulated or advised in some way by their lead organisation, rather than by the Commission directly.

We think there are serious flaws in the 'sub-regulator' approach, namely:

- The possibility that whole classes of charity were removed from the central register, thus breaking up what is potentially the most comprehensive single point of access for consistent information about charities for the public.
- The boundary between informal advice and formal regulation would likely be made less clear with a sub-regulator approach. At what point would a membership body be involved in enforcement actions against a member? What would be the legal implications? Would this lead to greater litigation, and in the end, costs for the Commission?
- The idea that existing membership bodies could absorb a significant amount of extra responsibility without any additional financial resources is fanciful.

Key Point – the significant downsides and risks of a ‘sub-regulator’ approach need to be fully considered in any reform, particularly the potential impact on the integrity of the register of charities.

6. The definition of charity and the public benefit requirement

The consultation raises a number of issues around the public benefit requirement introduced in the 2006 Act, including the possibility that a statutory definition could be introduced. We fail to see the need for further changes to the definition of charity or further exploration of the public benefit requirement. Neither should be seen as a priority at this time. Public benefit in particular has taken years and millions of pounds to come to a kind of legal resolution – we do not need to use limited resources on the issue.

Instead, the Commission needs to be able to focus on how it will provide clear guidance to charities on demonstrating public benefit in the future, in the light the Upper Tribunal case. Charities should be focused on how to demonstrate adequately their public benefit using that guidance.

We need to heed the lessons of the past – for example that the Charitable Incorporated Organisation has not even been fully implemented. We are simply not in a position to expend more resources on new and untested forms that may prove too difficult to conceive or may not wind up meeting their intended purposes.

It would be more useful to focus limited resources on how charity reporting could be made simpler and clearer, to benefit the public, and so enhance transparency and effective self-regulation. In particular, how Trustees Annual Reports could be improved, so that the public can have access to clear information about what a charity does.

Key Point – further reforms to the law and regulation around public benefit should not be attempted at this time. The Commission and charities need to focus on addressing the question of public benefit as determined in the 2006 Act and the outcome of the Upper Tribunal case.

7. Charity registration thresholds / reporting and accounting requirements

The consultation contains two separate calls for evidence on registration thresholds and reporting/accounting requirements for charities.

7.1 Reporting requirements

It would seem that there could be some benefit in rationalising the reporting requirements for charities, to simplify them for all concerned, and hopefully to result in more effective use of limited resources.

In our response to the OTS/Charity Commission consultation on reporting thresholds in 2008, DSC argued the following:

We think that a simpler system of thresholds than what has been proposed would make it easier for charities to understand and comply with their obligations. Enabling organisations to understand and adhere to regulation will be vital in the success or failure of the Commission's 'risk-based' approach.

We propose that there be three or four main income thresholds, which would conveniently increase by factors of ten. These are outlined below and discussed in more depth in our responses to the consultation questions.

- **£5000** – charities required to register with the Commission and submit Annual Returns (which could include a very simple financial statement and an optional or simplified version of the Trustees Report describing the charity's activities).
- **£50,000** – charities required to prepare and submit accounts and Trustees' Annual Reports that meet the Commission's requirements (SORP etc). Accounts must be externally scrutinised.
- **£500,000** – charities required to prepare accruals accounts which are scrutinised by a qualified Independent Examiner.
- **£5,000,000** – non-company charities required to have their accounts audited – unless a clear justification can be provided for why this threshold should remain 10 times lower (or 5 times lower as proposed) than it is for private companies – in which case we would recommend leaving the threshold at £500K for simplicity's sake.

We believe that simplifying the system of thresholds would benefit charities of all sizes, not just small charities. The thresholds we have proposed above are high enough that they would not need to be amended for some time (given the impact of inflation on incomes). This would help to embed them in the consciousness of the charitable sector for many years. We would anticipate that this would eventually help reduce the amount of 'hands-on' regulatory activity the Commission has to do, by making complying with regulation much easier and more straightforward.

At the time our position was not shared by others in the sector, as there was a feeling from national organisations and membership bodies that various thresholds needed to remain in place – perhaps now there is a case for exploring it again.

Key Point – The Review should explore whether further simplification of reporting thresholds could benefit charities, the public and the Charity Commission.

7.2 Registration thresholds

We would argue that the registration threshold of £5000 remain in place – partly in the interest of providing comprehensive information to the public about charities, but also because being registered is often key to all kinds of fundraising. However, as we suggest above, the information required as part of registration could be looked at.

Further, we know that often organisations wish to be registered that do not meet the threshold. Our understanding is that voluntary registration below the £5000 amount is technically allowed under the law but the Commission is currently not allowing it because of pressures on its resources.

The current situation could have the negative impact of discouraging all kinds of important work. It is a bit of a chicken and egg problem – often organisations need the charity number to fundraise effectively, but they can't get registered without sufficient funds. We would recommend the review look at this issue in more detail.

Key Point – we would recommend further targeted consultation with small charities and their representative bodies, specifically on the issue of voluntary registration below £5000 income, and whether the current regime acts as a barrier to the development of such charities.

8. Mixed motive investment

The consultation poses a number of questions about social investment and mixed-motive investment.

For DSC it is a fundamental principle that charities should not be owned or controlled by 'investors'. We think this sentiment would be shared by the general public and the vast majority of people who support and give time and money to charities.

If people are allowed to 'invest' in and effectively own a charity, and have some direct or indirect influence over what that charity does, what is the point of that organisation being a charity at all? How does this complicate the roles and responsibilities of charity trustees? There are other organisational forms available which would allow investment and returns for investors, which can achieve the same aims as charities.

On social investment and mixed-motive investment, we would also make the following points:

- We think the 'regulatory barriers to social investment' are largely overstated. Such 'barriers' that exist may be in place for good reason. Under the law trustees have been allowed to invest for purposes other than to purely maximise financial return even prior to the Charity Commission's revision of its guidance on the subject.
- There is a clear policy agenda from government to try and drive social investment for a number of reasons. Mainly this is narrowly defined in terms of things like Social Impact Bonds, which remain largely untested and are primarily aimed at delivering and financing public services. Social investment may benefit some organisations but is not necessarily in the interests of the wider charity sector.

Key Point – Any reform in the guise of ‘social investment’ which allowed investors to influence or control charitable activity would not be in the public interest. Regulatory changes which could potentially affect all charities should not be made on the basis of a narrow interest group or a particular Government’s policy agenda.

9. Merger, restructuring and winding up

One of DSC’s policy principles is that we believe in ‘more charities, not less’. We do not agree with those who say that there are too many charities – in fact we believe the opposite.

Charities and other voluntary groups exist to serve people’s needs, advance important social causes, and improve community life. By engaging citizens as volunteers, donors and beneficiaries, they help maintain the social fabric. They spring up and develop where and when people feel they are needed.

They are not instruments for governments or other funders to manipulate or control for their own ends. No charity should exist for its own sake, but that does not mean they should be forced to merge or disappear because of external pressures.

It is a kind of democratic right in a free society to be able to set up organisations for the benefit of the community. We would be against greater restrictions being introduced with the intention of making it harder to register a charity, because:

- Society and government clearly need to encourage the civic activism that charities represent, not put in place barriers to it;
- A government agency may not fully understand key differences between charities that appear similar on paper, and so cannot necessarily make an informed decision about what is ‘duplication’ and what is distinct;
- There is a need for diversity of provision, even if there is inevitably competition for resources. It is better for beneficiaries to have more options for charitable help than fewer.

However, the Charity Commission can play a useful role in signposting people who wish to start charities towards existing ones. This is an area that the review could usefully explore.

On winding up, DSC has always said that no charity should exist for its own sake, and that if a charity fulfils its purpose it should be able to wind up with a minimum of difficulty.

There may be issues that could be addressed in this review around the ease with which charities can wind themselves up or give their assets to other charities. This may particularly be the case with some charitable trusts whose assets are no longer able to be used in the service of their objects.

Key Point – The Charity Commission should not refuse to register charities on the basis of supposed ‘duplication’ or grounds of ‘efficiency’. However, the Review could usefully investigate the way the Commission signposts prospective new charities towards organisations already in existence which do similar work. A sub-theme would be the way potential

philanthropists who wish to set up new trusts or foundations could be encouraged to give their money to a pre-existing charity.

The question of winding up or transferring the assets of grant making trusts which are no longer able to act within their objects also should be examined further.