CHARITY COMMISSION
FOR ENGLAND AND WALES

COMPLIANCE TOOLKIT: PROTECTING CHARITIES FROM HARM

Chapter 2: Due diligence, monitoring and verifying the end use of charitable funds: summary

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Trustees' responsibilities

The public and those donating to charity should have confidence that money donated is used for legitimate purposes and is reaching its intended beneficiaries.

First and foremost, it is the trustees of charities who are legally responsible for ensuring that charitable funds are properly used. Trustees are the custodians of their charities. They are publicly accountable, and have legal duties and responsibilities under charity law to safeguard their charity, its funds and property.

The best way that trustees can ensure a charity's funds are not abused in the first place is by putting in place good governance and ensuring there is strong financial management, including having robust internal and financial controls and risk management procedures. A significant aspect of a trustee's legal duty to protect charitable assets and to do so with care means carrying out proper **due diligence** on those individuals and organisations that give money to, receive money from or work closely with the charity.

Where charities give money to partners and beneficiaries, especially large amounts of money or in high risk situations, making sure that adequate **monitoring** takes place is crucial. This means verifying that charity funds or property reach their proper destinations and are used as the charity intended. What an individual charity and its trustees must or should do in their charity and what is a proportionate approach to adopt will depend on a range of factors. These will include various aspects of the charity's work and the associated risks, how much money is involved, whether the charity works with partners and whether those partners or the charity's funds are overseas, and if so, where.

What is the purpose of this guidance?

The guidance in this chapter aims to make all charity trustees aware of their legal duties and responsibilities in carrying out **due diligence** checks and **monitoring** in relation to the charity's involvement with external bodies and individuals. These duties are not new. They are part of charity trustees' existing duties.

Who should read this guidance?

This chapter is primarily intended for trustees and others in their charity, but will be of interest to donors and organisations which give grants to charities to deliver project work in the UK and internationally, so they understand trustees' responsibilities under charity law. The 'tools' are particularly aimed at smaller and medium sized charities. The guidance will also assist partner organisations and other delivery agents which charities engage to carry out their work and help them to understand why a charity may have certain reporting requirements or need certain information from them.

What are the risks of not having effective due diligence and monitoring?

Most of the time charities have good relations with their donors, partner organisations and beneficiaries who give to or work with charities in good faith. However, practical risks do exist and charities can be abused in a number of ways, for example:

Donors

1. Money laundering: donors can make loans to charities as a means of laundering money through a charity or they can make donations with specific restrictions as to which partner or project is to be funded as a means of transferring funds overseas and disguising the origin of the funds.
2. Proceeds of crime: anonymous cash donations or donations through suspect third parties may be a means of disposing of the proceeds of crime.
3. Tax avoidance/evasion: donors may seek tax relief on their donation while at the same time seeking private benefit as a result of their donation or insist that the charity purchase services from an associated company as a condition of the donation, thereby obtaining tax relief on the donation and securing business at the same time.

Trustees should be aware of any funding relationship which involves a return of part or whole of the cash donated to the donor or where the donor benefits in any substantial way as a result of making the donation. Third parties making donations on behalf of a donor who wishes to remain anonymous may also be a cause of suspicion unless the third party is reputable or allows trustees to know the name of the donor with the proviso that this is not made public.

Beneficiaries

Knowing who a charity's beneficiaries are is particularly important if the charity makes grants of cash or other financial support directly to individual beneficiaries; or if distribution of cash or support is through a third party. Without due diligence and sound procedures, payments may be made to individuals who do not qualify as beneficiaries and who are seeking to abuse the charity.

Partners

Partners who are funded to implement a project or deliver aid are in a position to abuse these funds unless:

- the charity is sure they are bona fide organisations
- the charity has evidence that the partner can implement the programme in the way expected
- the partner's internal management and financial control systems enable them to identify and report losses or abuses back to the charity

Overseas partners may be subject to control by or have affiliations with proscribed organisations or designated entities, or have weak internal controls which means that their funds are potentially open to fraudulent claims or theft by others.

In the light of these types of threat, it is vital that trustees take a risk based approach in their relations with their donors, beneficiaries, and partners.

A risk based approach

Trustees' legal duties and responsibilities apply to all charities and all trustees, whatever the charity, its size and activities. What this means in practice, however, depends on the circumstances. The extent, form and detail of the required project and partner due diligence checks and monitoring, and how this should extend to donors and beneficiaries, will depend on the nature of the risks in the particular circumstances, the activities the charity carries out, and how and where they are undertaken. This is why a risk-based and proportionate approach is important and more appropriate than a 'one-size-fits-all' approach.

Trustees cannot apply a risk based approach as to which duties apply or they choose to comply with. The legal duties explained above apply to **all** trustees of **all** charities subject to the law of England and Wales, whatever their income, whether registered with the Charity Commission or not and whether or not they are based, operate or work internationally. However, what action is reasonable or proportionate to take to ensure trustees comply with these duties will vary from charity to charity. Charities can apply a risk based approach to this.

The starting point is the greater the risks, the more charity trustees need to do.

All charities must have, as a minimum:

- some form of appropriate internal and financial controls in place to ensure that all their funds are fully accounted for and are spent in a manner that is consistent with the purpose of the charity; what those controls and measures are and what is appropriate will depend on the risks and the charity
- proper and adequate financial records for both the receipt and use of all funds together with audit trails of decisions made; records of both domestic and international transactions must be sufficiently detailed to verify that funds have been spent properly as intended and in a manner consistent with the purpose and objectives of the organisation
- given careful consideration to what due diligence, monitoring and verification of use of funds they need to carry out to meet their legal duties
- taken reasonable and appropriate steps to know who their beneficiaries are, at least in broad terms, carried out appropriate checks where the risks are high and have clear beneficiary selection criteria which are consistently applied

What do trustees have to do for due diligence?

Due diligence is the range of practical steps that need to be taken by trustees so that they are reasonably assured of the provenance of the funds given to the charity; confident that they know the people and organisations the charity works with; and able to identify and manage associated risks.

What trustees need to apply to undertake due diligence can be described as the 'Know your' principles:

- know your donor
- know your beneficiaries
- know your partner

These are the principles that trustees should follow to ensure that they meet their legal duties under charity law when they are selecting donors, partners and beneficiaries.

The 'Know your' principles are already part of the legal duties and responsibilities of trustees in charity law. They are not new obligations. Similar 'Know your' principles and responsibilities exist in other sectors.

The core elements of due diligence across each of the 'Know your' principles involve trustees taking reasonable steps to ensure they:

- **identify** – know who they are dealing with
- **verify** – where reasonable and the risks are high, verify this
- **know what the organisation's or individual's business is** and can be assured this is appropriate for the charity to be involved with
- **know what their specific business is with the charity** and have confidence they will deliver what the charity wants them to
- **watch out** for unusual or suspicious activities, conduct or requests

Know your donor

Charity trustees need to put effective processes in place to provide adequate assurances about the identity of donors, particularly substantial donors, and to verify this where it is reasonable and necessary to do so (**identify and verify**).

Most charities should know, at least in broad terms, where the money they are being given comes from (such as grants or cash donations). It does not mean charities must question every donation or ask for personal details about every donor. Trustees are likely to need to carry out further due diligence and take steps to identify and verify the identity of more significant donors so they can assess any risks. If there is a significant donor which is an organisation, the charity should know **what their business is** and be assured that the organisation is appropriate for the charity to be involved or associated with.

Trustees should also be reasonably assured about the provenance of funds and the conditions attached to them (trustees should know what their **specific business is with the charity**). If there are particular risks, for example where an unfamiliar donor operates a business or is perhaps from a country outside of the UK about which public concerns have been raised, then the trustees should take more steps to verify the provenance of the funds.

The Know your donor principle does not mean charities cannot accept anonymous donations. This is perfectly acceptable providing charities look out for suspicious circumstances and put adequate safeguards in place.

A charity's responsibility is not to work out if a donation is illegal or if it is being asked to use a donation for illegal purposes. However, trustees should carry out good due diligence and report concerns and suspicious activities.

Know your beneficiaries

A common sense approach to the Know your beneficiaries principle is required. Trustees have a duty to ensure that their charity's funds are used for its beneficiaries, so it is important that trustees are clear, in a general sense at least, about who the beneficiaries are. The amount of detailed knowledge at an individual level will depend upon the activities of the charity and the number of beneficiaries.

For example, a charity providing a recreation ground does not choose its beneficiaries as such and clearly, there is no need to check and verify the identity of members of the public who walk across or use the ground. The principle is more likely to apply to charities which restrict access to services or activities to a certain number of beneficiaries.

Trustees need to be alert to the risk that some people abuse charities by making false applications to the charity for grant funding or for individual assistance, including creating beneficiaries that do not exist. Again, a charity's responsibility is not to investigate or determine criminality. Trustees should carry out good due diligence and take enough reasonable steps to satisfy themselves their beneficiaries are genuine. If they suspect a crime has been committed, or the charity's money or help is being used for illegal purposes by a beneficiary, they must report their concerns and suspicious activities to the appropriate authorities.

Where decisions are made regularly about selecting which particular individual receives services or support from a charity, trustees need to take reasonable and appropriate steps to ensure that:

- they know who those individuals are
- where the risks are high, appropriate checks are carried out
- it is appropriate for the charity to provide assistance to them, both in terms of them meeting any eligibility criteria, and there being no concerns that the charity's assistance will not be used as intended

Know your partner

Trustees must carry out appropriate and proper due diligence on individuals and organisations that the charity gives grants to or uses to carry out charitable projects and help deliver its work. This involves the trustees assessing the risks to ensure that those partners are suitable and appropriate for them to work with.

Due diligence steps are likely to include obtaining the key details about who the partner is, where it is based and who the charity will be involved with. These details are likely to be required in practice anyway to arrange for payment of any funds to the partner. Where the risks are high, or the more significant or substantial the work or partnership is, trustees will need to carry out more extensive due diligence, taking steps to **identify and verify** the identity of the partner and further assess the risks.

Trustees should have reasonable confidence that they know enough about what the partner's business is and they are an appropriate partner for the charity to be involved with, as well as being clear what they intend to deliver for the charity, when and how (trustees should know what their **business is with the charity**).

It is for trustees to decide the level of due diligence and the type of checks they need to carry out. The nature and extent of due diligence checks should be proportionate to the risks involved in the project and from entering into a new relationship or extending an existing one.

Trustees need to be alert to signs that the charity's funds will not be properly or legitimately used by partners.

What do trustees have to do for monitoring and verifying the end use of funds?

Trustees must be able to demonstrate that charitable funds have been used for the proper purposes for which they were intended. Monitoring is an important way for trustees to ensure they are able to account for the proper use of the charity's funds and that they maintain donor confidence. This includes taking appropriate and reasonable steps to verify the proper end use of funds where the charitable funds are provided to partners.

Monitoring may take a variety of forms depending on the nature of the charity's work, the particular project and amount of charitable funds involved. It will almost always include steps to verify the proper end use of funds.

Drawing up robust monitoring processes, and recording and implementing them will help trustees ensure that funds are adequately protected from abuse, misuse or other loss, and are being put to their most effective use.

Monitoring will usually involve steps aimed at ensuring:

- the charity's funds can be accounted for
- there is an audit trail showing the expenditure of funds by the partner
- the funds were received by the partner and if the partner forwarded those funds on, there is an audit trail to show this
- the partner has actually delivered the project and charitable work expected
- the charity's funds have been used for the purposes for which they were intended and the beneficiaries identified by the charity have benefitted
- any concerns that need to be dealt with are identified

The risk based approach recognises that not all partners and financial transactions need to be monitored in exactly the same way. However, if monitoring reveals suspicious circumstances or that non compliance may have taken place, then there will be much less flexibility in how trustees deal with this.

Verifying the end use of funds is one aspect of monitoring. It is the process of ensuring money has both physically reached the partner and that it has been spent by them properly and as the charity intended.

Key points for trustees to remember

Due Diligence

1. Look out for suspicious circumstances and exceptional features.
2. Have clear policies and procedures in place to ensure you as trustees, your staff and volunteers know what to do if they identify something suspicious or which poses particularly high risks.
3. Where there is a cause for concern carry out further checks.
4. Make sure you report suspicious activities to the relevant authorities, including the police, if you think a crime has been committed.
5. Carefully consider and record any decisions to refuse donations or accept donations which may present particularly high risks.

6. Be alert to the risk that some people abuse charities by making false applications to the charity for grant funding or for individual assistance, including creating beneficiaries that do not exist; people who may appear to be legitimate beneficiaries may make requests for support they do not qualify for or need.
7. Be alert to signs that the charity's funds will not be properly or legitimately used by partners.
8. Keep a written record of due diligence processes and the results which informed your decision making.
9. Have reasonable assurance that any partner your charity is going to work with can deliver the activities or services required.
10. If you suspect that a partner may be bogus or you are suspicious about them or their work, consider not taking forward the proposed project with the partner.
11. It is good practice to protect the charity's position with a partnership agreement.
12. Seek professional advice where appropriate.

Monitoring

1. Consider which monitoring tools work best for you and your charity's work.
2. Make sure the monitoring you carry out is effective and credible.
3. Ensure your staff and agents are competent to undertake monitoring and any conflicts of interest are dealt with properly.
4. Make sure you keep an audit trail for the movement of funds from your charity to your partners.
5. Make sure you keep an audit trail and proper records (such as receipts and invoices) that show the partner has spent the funds as intended and for proper purposes.
6. Look out for signs of suspicious activities or signs that audit trails and other records may not be in order.
7. Consider asking for progress reports from partners.
8. If you carry out joint monitoring, ensure you put safeguards in place and are clear about who is doing what.
9. Consider some form of reporting back of significant project work to donors and supporters of the charity .
10. Where there is a cause for concern carry out further checks.
11. Make sure you report suspicious activities to the relevant authorities, including the police, if you think a crime has been committed.
12. Make sure your charity's culture is that abuse and misconduct are not acceptable and your trustees, staff and volunteers know this.

For further information and guidance on trustees' duties and responsibilities, what a risk based approach to due diligence and monitoring means in practice and how this might affect the work of charities that operate internationally in particular, see the relevant sections of the full guidance. For practical guidance, including checklists, example forms and aide-memoires, see the tools section of chapter 2.