



CHARITY COMMISSION  
FOR ENGLAND AND WALES

GUIDANCE

# Charities and public service delivery: an introduction and overview (CC37)



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# 1. Introduction

## 1.1 What is this guidance about?

This introduction to public service delivery is primarily aimed at smaller charities and those charities considering delivering public services for the first time. The Charity Commission hopes it will also be useful to those charities that are already delivering public services. It gives an overview of the legal and good practice issues that charities need to consider. Some of the key questions the guidance looks at are:

- What are public services?
- Can charities deliver public services?
- Can charities use their own funds to pay for or contribute to services that public authorities normally provide or fund?
- What are the legal requirements that charities must comply with?
- What recommended good practice should charities consider?
- What risks should charities be aware of?
- What sources of help and advice are available?

This guidance focuses on the regulatory issues that charities need to consider. The commission has also signposted guidance produced by other organisations that provides further advice in this area.

## 1.2 'Must' and 'should': what the commission means

The word 'must' is used where there is a specific legal or regulatory requirement that you must comply with. 'Should' is used for minimum good practice guidance you should follow unless there's a good reason not to.

The commission also offers less formal advice and recommendations that trustees may find helpful in the management of their charity.

## 1.3 Previous guidance

This guidance replaces Charities and Contracts (CC37). It is a complete rewrite in a new format. The emphasis of the guidance has moved beyond just contracts to wider issues of funding and delivery, reflecting changes both within the charitable sector and in its relationship with the public sector.

## 1.4 How to use this guidance

The structure of this guidance follows the main headings used in the next section, 'Charities and public service delivery at a glance'. Under each heading, the commission asks a selection of questions that trustees or charity managers may have about public service delivery. Generally there is a concise summary answer ('the short answer'), and then more background ('in more detail').

## 1.5 Some technical terms used

Although the commission has tried to write this guidance in everyday language, it has had to use technical terms in places. This list explains some of them:

**Beneficiary:** a legal term for a person who is eligible to benefit from a charity's work. The beneficiary group of a charity will be defined in the charity's 'governing document'. Beneficiaries may sometimes be called clients or service users.

The Compact, established in 1998: a framework for partnership drawn up by government and the voluntary and community sector (it is not a legally binding agreement). There are also local compacts between the sector, local authorities and other local public bodies. The Compact has codes of good practice for Black & Minority Ethnic Groups, Community Groups, Consultation & Policy Appraisal, Funding & Procurement, and Volunteering. For further information see [www.compactvoice.org.uk](http://www.compactvoice.org.uk).

**The Voluntary Sector Scheme:** The National Assembly for Wales' Voluntary Sector Scheme fulfils the same role in Wales as the Compact does in England. The scheme sets out the broad principles and shared values which govern the relationship between the National Assembly and the voluntary and community sector in Wales. For further information see the Voluntary Sector Scheme page on the Welsh Government's website [www.wales.gov.uk](http://www.wales.gov.uk).

**Governing document:** a legal document setting out the charity's purposes and, usually, how it is to be administered. It may be a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal Charter, scheme of the commission, or other formal document.

**Mission or mission statement:** a term used by many charities to describe why they exist and what impact they want to have. A mission statement can:

- provide an explanation of the charity's 'objects' or 'purpose' in everyday language
- help to communicate the charity's ethos and values
- provide a focus for strategic planning by defining the particular outcomes or goals that the charity wants to achieve

A charity's mission (or mission statement) must be consistent with and not wider than its objects.

**Objects or purposes:** the legal purpose(s) for which a charity exists, or the thing(s) it was set up to achieve, as set out in its 'governing document'. The objects may be worded quite broadly and expressed in legal language. They direct (and consequently restrict) how the charity's assets must be used.

**Public authority:** any organisation that is part of national or local government, including the Welsh Government, government departments, county and district councils and NHS bodies. Such organisations are often referred to as 'commissioners', ie bodies that commission services.

**Commissioning and procurement:** processes by which public authorities usually obtain services, starting with identifying the need for a service, through setting the service specification to acquiring or purchasing the service.

**Trustees** means charity trustees: these are the people who serve on a charity's governing body. They may be called trustees, directors, board members, governors, committee members or some other title. They are responsible for the general control and management of the administration of the charity. (Other types of trustee are not mentioned in this guidance.)

**TUPE:** the Transfer of Undertakings (Protection of Employment) Regulations 2006 protect the rights of employees who are transferred from one employer to another, requiring the new employer to maintain certain terms and conditions such as pay, leave and pension entitlements.

**Voluntary and Community Sector:** charities are a significant part of a wider sector in society known as the Voluntary Sector or Voluntary and Community Sector (VCS). Not all voluntary and community organisations (VCOs) are charities. The VCS includes all organisations that are neither part of government (public or state sector) nor the private (for profit) sector. Many documents on public service delivery refer to the VCS, not just to charities.

This sector is sometimes also known as the 'Third Sector or Civil Society.' The commonly used definition of the Third Sector also includes social enterprises (some of which are charities), co-operatives and mutual societies.

## 2. Charities and public service delivery at a glance

### 2.1 Charities and public services

By 'public services' the commission means services that public authorities normally provide or commission. Not all public services are provided under a legal duty; some are provided under discretionary powers (in other words, they are optional). Even when there is a legal duty, the law does not always specify exactly what level of service must be provided.

It is up to charities to decide on the most effective way to meet their beneficiaries' needs. To those charities that choose to engage in public service delivery, the commission advises:

- stick to your mission
- guard your independence
- know your worth

#### The charity law framework (legal requirement)

There is no general legal prohibition on charities delivering public services under a funding agreement with a public authority or using their own funds to do so. This does not alter the trustees' responsibility to comply with charity law and the requirements of the charity's governing document.

The following legal rules apply to all charities but are particularly relevant to charities delivering public services:

- charities must only undertake activities that are within their objects and powers
- charities must be independent of government and other funders
- trustees must act only in the interests of the charity and its beneficiaries
- trustees must make decisions in line with their duty of care and duty to act prudently

#### Understanding the risks (legal requirement)

Public service delivery presents both opportunities and risks for charities. Key risk areas include financial risks, the risk of compromising the charity's independence, the danger of mission drift, service delivery and contractual risks, and reputational risks.

Any charity that is considering public service delivery should weigh up the risks and the opportunities. It is important to recognise and manage risks, and ensure they are appropriately shared between the charity and the public authority.

Trustees must not agree to any contract or funding agreement unless they are satisfied that its terms are in the charity's interests. They should therefore consider the need for professional (legal and accountancy) advice on the terms of such documents.

#### Stick to your mission (legal requirement)

A charity's mission and all of its activities must be within its objects and powers. Equally it should be clear how any activity contributes to achieving the objects and mission.

Trustees have, and must accept, ultimate responsibility for directing the affairs of their charity. They should ensure that they are appropriately involved in decisions about what activities the charity undertakes. Where decision making is delegated, trustees should set clear parameters about how, and by whom, such decisions can be made, and how the trustees will keep themselves informed about the charity's activities.

The following questions should be considered by all trustees when considering whether their charity should carry out any activity or service, but are particularly relevant to charities considering the delivery of public services:

- Is this activity consistent with the charity's objects and powers?
- How does it fit in with the charity's mission and any specific aims or objectives within our current work plan?
- How will it meet the needs of the charity's beneficiaries?
- How will it be funded? (This is discussed in more detail in the rest of this guidance.)
- Has the charity fully assessed the risks and taken steps to mitigate them?

As good practice, trustees should periodically review the charity's objects and mission, to ensure that they are still appropriate.

### Guard your independence (legal requirement)

In carrying out his or her responsibilities, a trustee must act solely in the interests of the charity. A trustee is not a delegate or representative of any appointing or funding body. It is essential that all trustees understand their legal duties, and conflicts of interest are managed.

Charities that deliver public services should not feel inhibited from engaging in political activity or campaigning; the same rules apply to all charities, regardless of their other activities. For more information read **Speaking out: guidance on campaigning and political activity by charities (CC9)**.

### Know your worth

By 'knowing your worth' the commission means:

- understanding the full cost of the charity's services
- recognising the charity's scope to deliver and any limitations
- identifying any unique or distinctive qualities of the charity's services
- using these and other relevant factors to set a price for those services

Full cost recovery should apply in any case where a public authority is purchasing a service from a charity, unless it is in the charity's interests to forego full cost recovery. Charities are allowed to achieve a surplus on funding agreements.

If a charity is either considering taking up, or renewing, a funding agreement for public service delivery where the funding on offer will not cover the full cost of the service, it can:

- negotiate for more funding
- offer a lower level of service commensurate with the funding on offer
- decide to use other funds to make up the shortfall
- reject the funding agreement and not deliver the service

The charity's decision must be based on the interests of the charity and the needs of its beneficiaries. There are particular questions that the trustees should consider before deciding to use charitable funds to make up the shortfall, which are detailed in this guidance.

There may be steps that a charity could take to make a public authority comply with the Compact or a statutory duty. These are detailed in section 8 of this guidance.

## Guidance for charities that give grants

Grant-making charities should only be asked, and should only agree, to subsidise public services or other public provision when there is clear justification for doing so.

In considering applications for funding in connection with public service delivery, the commission recommends that grant-making charities:

- consider the full range of funding options
- ensure that decisions are based on the law and the interests of the charity's beneficiaries
- use their experience of what public authorities have funded in the past
- ask questions and challenge assumptions about what public authorities are prepared to fund or have a duty to fund
- use such considerations to inform grant-making policies

## Other issues to consider

There are steps that charities can take to manage some of the risks associated with public service delivery, including adopting the form of a limited company ('incorporation'), using insurance, or delivering the service via a trading company.

Where partnership is appropriate it can enable charities to compete for larger contracts or benefit from efficiency gains by reducing duplication of administrative functions. This may be of particular benefit to smaller charities. Charities need to consider the benefits and risks before entering into partnership or collaborative working arrangements. These are explained in more detail in the guidance **Collaborative working and mergers: an introduction (CC34)**.

In general, charities receive no special treatment in respect of VAT on their business activities. VAT registration is required if their taxable turnover exceeds the statutory limit. A charity can discuss any aspect of VAT which affects it with the HM Revenue & Customs National Advice Centre.

### 3. Charities and public services

#### 3.1 What are public services?

##### The short answer

By 'public services' the commission means services that public authorities normally provide or commission. (Some examples follow.)

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##### In more detail

'Public services' include a wide range of services provided or commissioned by public authorities. These services include:

- advice and advocacy
- care of the elderly and provision of sheltered accommodation
- education
- medical care and treatment
- museums, art galleries and libraries
- recreational and leisure services
- recycling, refuse collection and disposal
- social housing
- urban or rural regeneration

For centuries, charities have undertaken activities that people now tend to think of as 'public services', and charity often pre-dated and prompted, statutory provision. For example, state education didn't exist until the mid-19th century, and the National Health Service was founded in 1948. Before then, schools and hospitals were provided by charities. Public perception of what government should provide changes over time, as do relative levels of provision by the charitable and public sectors. Public authorities have taken over responsibility for some services in response to changing public expectations, government policy and statutory duties. More recently, whilst retaining responsibility for the provision (or funding) of services, public authorities have contracted out delivery of some services to private or voluntary sector organisations.

Public authorities do not always have legal duties to provide all of their services; some services are provided under discretionary powers (in other words, they are optional). Even when there is a legal duty to provide a service, the law does not always specify the level of service that must be provided.

The commission cannot give authoritative advice on the duty of public authorities to provide or fund particular services, but section 8 of this guidance sets out some of the steps that a charity may take to obtain clarification of a public authority's duty.

### **3.2 Are there differences of approach between England and Wales?**

The English and Welsh governments are each responsible for developing their own initiatives for involving charities and other VCS organisations in public service delivery.

There may be differences of emphasis between England and Wales, but charities in both countries face similar issues as highlighted in this guidance.

### **3.3 Can charities contribute to the improvement of services without delivering them?**

Charities can play a key role in bringing about improvements to services that their beneficiaries receive, (regardless of whether they actually deliver those services), by using their experience of beneficiaries' views and needs, including any barriers to accessing services, to inform and influence the design and delivery of public services.

Where charities provide advice about the design and delivery of services, they should consider whether they are, in fact, providing free 'consultancy' or giving away intellectual property. This information can be valuable and charities should consider whether they are being fairly rewarded or funded for it.

## 4. The charity law framework

### 4.1 What does the law say about charities delivering public services? (legal requirement)

#### The short answer

Very little. There is no general legal prohibition on charities delivering public services under a funding agreement with a public authority or using their own funds to do so, even if the authority has a legal duty to provide the service. This does not alter the trustees' responsibility to comply with the requirements and restrictions of charity law as summarised in this section, the requirements of the charity's governing document and other legal requirements that may apply to the charity.

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#### In more detail

The key legal principles are as follows:

- charitable purposes are broad, and may overlap with the duties of a public authority
- there is not a legal bar on using charitable funds to deliver public services or facilities, but case law establishes a principle that charitable funds should be used reasonably and prudently
- many legal duties of public authorities are not precisely defined in law

This does not alter the trustees' responsibility to comply with charity law and the charity's governing document.

New charities: a charity can be set up to deliver, either exclusively or as part of a wider range of activities, a particular public service or services. The organisation must be set up for exclusively charitable purposes for the public benefit (the legal test for charitable status), and not simply as a means of carrying out a public authority's duties or policy.

Existing charities: the relief of taxation is a charitable purpose provided it is for the public benefit. Very few charities have this express charitable object, but they and charities with general charitable purposes can directly subsidise public funds, provided they can show that this is for the benefit of the public.

Without either this specific object or general charitable purposes, a charity cannot apply its funds directly for the relief of taxation. However a charity would not need these particular objects provided the trustees are satisfied that any relief of taxation is only an incidental consequence of achieving the charity's stated charitable purpose.

Other legal requirements: charities must of course comply with any other laws that apply to them. Some laws apply to all charities; others will apply to particular charities because of the kind of work they do or the beneficiaries they work with. Charities need to take advice on this as appropriate to their circumstances. Charities might need to consider, for example:

- employment law
- health and Safety law
- equality law (for further information see the guidance on **Charities and the equality act**)
- safeguarding vulnerable beneficiaries (for further information see the guidance on **safeguarding children**)

## 4.2 What requirements of charity law must trustees comply with in undertaking public service delivery? (legal requirement)

### The short answer

The following legal rules apply to all charities but are particularly relevant to charities delivering public services:

- charities must only undertake activities that are within their objects and powers
  - charities must be independent of government and other funders
  - trustees must act only in the interests of the charity and its beneficiaries
  - trustees must make decisions in line with their duty of care and duty to act prudently
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### In more detail

The charity's objects and powers: charities must always operate within the objects in their governing documents. The objects may refer to a specific locality or beneficiary group (for example based on gender, age, disability or need). The particular kinds of services or activities that the charity can undertake may be specified.

Charities must also operate within their legal powers. Usually, a charity's powers will be found in its governing document, but powers can also be contained in legislation or case law.

Trustees should understand, and be able to explain, why the charity is undertaking any activity and how it furthers the charity's objects.

Legal independence: in order to be a charity, an organisation must exist solely for charitable purposes, not for the purpose of carrying out the policies or instructions of a public authority. As evidence of this, the commission would look for a number of characteristics, which are explained in **The Independence of charities from the state (RR7)**.

This would not prevent a public authority from nominating or appointing trustees, or even being a trustee in its corporate capacity. Where this happens, however, conflicts of interest must be properly managed (see section 7, Guard your independence).

Interests of the charity: trustees have an overriding duty to act in the interests of the charity and its beneficiaries. This means:

- they must never allow their personal interests, or the interests of another organisation or body, to sway their judgement
- they must never place restrictions on themselves, or allow restrictions to be placed on them, that would limit their ability to make decisions in the interests of the charity

In practice, few charities can assist every potential beneficiary, and trustees have to make difficult choices about priorities. Trustees should consider the needs of both present and future beneficiaries, and allow this to inform decisions about funding and sustainability. For example, trustees may feel there are short-term advantages to be gained, such as the ability to reach new beneficiaries, by providing a service that does not cover its own costs. In the longer term, however, the advantages may be out-weighed by the effect on the level of the charity's reserves, its overall financial stability and its ability to carry out other work.

Duty of prudence: to comply with their duty of prudence, trustees must:

- ensure the charity is and will remain solvent
- use charitable funds and assets reasonably, and only in furtherance of the charity's objects
- avoid undertaking activities that might place the charity's endowment, funds, assets or reputation at undue risk; and take special care when investing the charity's funds or borrowing funds for it to use

This may mean, for example, taking independent professional advice on matters where the trustees don't have sufficient expertise (which could include contract drafting and negotiation - see section 5.4 of this guidance).

For more information about this duty, see **The essential trustee: what you need to know (CC3)**.

Duty of care: trustees must give enough time, thought and energy to their duties, and make reasonable use of their skills and experience. The specific 'duty of care' in the Trustee Act 2000 is to exercise such care and skill as is reasonable in the circumstances having particular regard to:

- any special knowledge or experience that the trustee has or professes to have
- where a trustee acts in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession

Strictly speaking, this only applies to trustees of unincorporated charities who are exercising powers in the Trustee Act 2000, or when they exercise similar powers derived from another source. However, case law and the Companies Act 2006 impose similar duties on directors of charitable companies. Good practice means that the duty of care should be considered as applying to all trustees and to all aspects of their work in making decisions about their charity.

The trustees' duty of care is explained in more detail in **The essential trustee (CC3)**.

## 5. Understanding the risks

Public service delivery presents many opportunities for charities, but there are also potential risks. Trustees should make informed decisions about whether to engage in this kind of activity and the terms on which they do so.

### 5.1 What opportunities might public service delivery offer to charities?

Public service delivery represents one way for charities to further their mission, expand their activities and provide new services to meet the needs of their beneficiaries. In principle, it should be properly funded and hence a potential source of income.

At the same time, it can be a means of improving the public services that beneficiaries receive, and an opportunity to influence public authorities' policy towards beneficiaries.

### 5.2 What risks should charities be aware of?

#### The short answer

Risk is a part of everyday life. Charities cannot avoid risk altogether, and sometimes real innovation and change are only achieved through taking risks.

Charities' experience of public service delivery to-date has highlighted the following potential risk areas:

- financial, including use of reserves and sustainability
- governance, including constitutional and independence
- service, including contractual risks, and quality of service
- reputational, including public perception and relationship with public authorities

Many of these risks do not arise solely from public service delivery, and charities may be familiar with them through other aspects of their work.

It is important for charities to be aware of any risks involved. The commission advises charities to use this information in considering and negotiating the terms of any funding agreement.

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#### In more detail

##### Financial risks:

- Under-funding: for example, this might occur if charities do not accurately identify the full costs of a service or negotiate for them in funding agreements. Using reserves or other funds to make up the cost of providing a service may affect a charity's long-term sustainability.
- Inappropriate duration of funding: short-term funding of a service can hinder a charity's long-term planning. It can also divert staff time and resources to obtaining further funding. HM Treasury's Guidance to Funders states that the length of funding should be determined by what the funding is intended to achieve.
- Block or spot-funding: some funding agreements are based on payment per client (spot-funding); others are for a 'block' of services (block-funding). Different arrangements may suit different circumstances. Spot-funding can be unpredictable if the charity has no control over how many (or few) client referrals it receives, making it difficult to plan staffing and resource levels. It may also entail the negotiation of a larger number of contracts. It may, however, be more flexible where services need to be tailored (and priced) to the specific needs of individuals.

- Late funding (payment in arrears): funding in arrears forces the charity to meet costs (including capital costs) up-front, causing potential cashflow problems. Government procurement rules permit payment in advance in certain circumstances.
- Funding linked to quality of service, or outcomes (eg payment by results): under some funding agreements, payment may be withheld if the quality of the service fails to meet specified standards, or specified outcomes (which may not be fully within the charity's control) are not achieved. If the specification is open to interpretation, this could lead to a dispute between the charity and the funder.
- Clawback: some funding agreements require repayment of any surplus. However, HM Treasury's Guidance to Funders makes it clear that clawback arrangements should only be applied when it is necessary to safeguard a funder's interest in a publicly funded asset (eg a building), that they should not apply in the procurement of goods or services, and that conditions attached to funding should be flexible and pragmatic.
- Statutory obligations: if staff transfer from the public sector to a charity, their terms and conditions may be preserved under TUPE regulations. The charity could become liable for additional salary, pension or redundancy costs. Existing staff may object if transferred staff have better terms and conditions.

#### **Governance risks:**

- Objects and mission-related risk: in order to obtain funding, there is a risk of charities undertaking activities or delivering services that are outside their objects or powers. (This is commonly known as mission drift and is discussed at more detail in section 4.)
- Loss of independence: see section 7.

#### **Service-related risks:**

- Contractual/litigation risks: as with any contract, entering into a contract to deliver public services entails assessment of the risks, as well as the opportunities. There may be penalties for non-delivery or other breaches of the contract. It may also require the charity to take on other contractual risks such as leasing premises or equipment and employing staff. It may be difficult to terminate a contract if arrangements do not work out as expected. Contract terms may be complex or unreasonable.

The terms of some tender processes can tie applicants into contractual agreements. In such cases a charity could be deemed by tendering to have accepted contractual terms unless it expressly reserved its position beforehand. Conversely, by seeking to reserve its position the charity might risk having its tender rejected.

Dealing with members of the public also involves risks of liability, for example personal injury.

- Inappropriate levels of monitoring: whilst it is to be expected that a funder will require a certain level of monitoring to ensure that agreed outcomes are delivered, inappropriate levels of monitoring may create an unjustifiable administrative burden and unnecessary additional costs. Inappropriate monitoring could also undermine the confidentiality of trustees' decision making (for example, observers attending all trustees' meetings).
- Public authority duty: public authorities have a number of responsibilities under human rights, freedom of information and equality legislation. Charities that deliver services under contract on behalf of a public authority may be required under contractual terms to comply with these duties, creating additional administrative requirements and costs. The charity should consider its obligations carefully. This area of law is currently under review.
- Sense of obligation: many charities understandably feel a sense of loyalty or responsibility towards their beneficiaries. They should not, however, feel obliged as a consequence to accept funding agreements on terms that are not in the interests of service users or other (present and future) beneficiaries.

- Risks to delivery or service quality: the framework and process of transferring services to charities can reduce their capacity to meet the expectations of service commissioners and beneficiaries. Poor contractual specifications, inappropriate monitoring arrangements and inadequate funding can all adversely affect service quality and value.

#### **Reputational risks:**

- Entering into contractual relationships with a public authority, and in particular using donated income to fund the delivery of a service, could weaken the confidence donors have in an individual charity, unless the charity clearly explains its approach.
- Unwillingness to exercise independence or to challenge funders might also affect a charity's reputation.
- Poor service quality could also harm a charity's reputation. Service users' frustrations may be directed towards the charity that delivers the service rather than the commissioning authority, particularly if the authority seeks to avoid responsibility for contracted out services; but there are reputational risks for both. Responsibility for resolving complaints about the service should be clearly set out within the funding agreement. As a matter of good practice, charities should have clear policies and procedures for handling complaints.
- There could also be a reputational risk in not delivering a service if that was contrary to the expectations of the charity's beneficiaries and other stakeholders.

For every aspect of a charity's work, the trustees should identify and assess the risks and decide how best to reduce, avoid or manage them. Part of negotiating a funding agreement with a public authority should be to examine the balance and sharing of risks between the charity and the authority. It is in no one's interests for the charity to carry an unfair burden of risk if this undermines the effectiveness and quality of the service and value for money.

Another way of managing or reducing some of the financial, contractual and delivery risks is to get involved in the commissioning (service design and specification) process at an early stage. Charities can positively influence the way services are shaped, using their understanding of beneficiaries' needs.

### **5.3 Should charities consider taking advice before signing a contract or funding agreement?**

#### **The short answer (legal requirement)**

Yes. In particular, trustees should take account of the size of the contract and any particular potential risks it may carry, when they are deciding what advice they need.

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#### **In more detail**

Contracts are legal documents. Terms of contracts and other funding agreements may be enforceable against the charity and may also contain penalties for non-performance. There are different legal considerations depending on the nature of the funding agreement (see 8.3, Different types of funding agreement). The terms should include, for example, the service to be delivered, payment terms, arrangements for monitoring and evaluation, service redress, provisions for any surplus or deficit, review and termination. There will often be obligations on the charity to indemnify the authority against third party claims, or possibly to take on certain premises or staff. The terms of the contract may not be in the charity's interests.

A public authority may try to insist that a contract is non-negotiable, but legally a charity should always have the choice to ask to negotiate or to refuse to sign. Charities should be careful, however, about entering into tendering processes where contractual terms may be imposed on the charity unless any amendments it wishes to negotiate are set out in its tender.

Trustees must ensure that no legal document is signed unless they are satisfied that its terms are in the charity's interests; to do otherwise would be a breach of duty. It is therefore essential for trustees to consider the need for professional (legal and accountancy) advice; particularly where the charity is considering entering into an agreement which is of high value compared to the charity's size or which carries potential risks. This advice could come from external or in-house specialists. Any trustees who are professionally qualified must consider their duty of care (see section 4.2 of this guidance) when deciding whether it is appropriate for them to advise their charity on any particular matter.

## **6. Stick to your mission**

It is essential that charities are clear about why they exist and who they are there to help, so that they do not lose direction. Lack of clarity about direction and purpose can be the first step towards mission drift. This section focuses on the relationship between a charity's objects or legal purposes and its mission, what it aims to achieve, and how this should direct its activities (which may include public service delivery).

### **6.1 How should a charity's objects govern its mission and activities? (legal requirement)**

A charity's mission and all its activities must be within the scope of its objects and powers. Whenever the trustees are revisiting their mission, they should always refer back to the objects. Equally it should be clear how any activity contributes to achieving the objects and mission. This is essential where charities are entering into contracts to deliver services, where the terms or scope of a funding agreement may not exactly match the charity's objects.

### **6.2 Who should make decisions about what activities the charity undertakes? (legal requirement)**

The trustees have, and must accept, ultimate responsibility for directing the affairs of their charity ensuring that it is solvent and well-run, and delivering the charitable outcomes for the benefit of the public for which it was set up. Trustees can generally delegate certain powers to agents or employees, and in practice managers may play a key role in day-to-day decision-making (particularly in larger charities). It is the trustees, however, who hold and must always retain ultimate responsibility for running the charity. They also have ultimate responsibility for ensuring that the charity complies with the terms of any contract.

Deciding what activities to undertake is one of the most important decisions that a charity makes. It follows that the trustees should ensure that they are appropriately involved in decisions about what activities the charity undertakes. Where decision making is delegated to staff or anyone else, trustees should set clear parameters about how, and by whom, such decisions can be made, and how the trustees will keep themselves informed about the charity's activities.

### **6.3 What should a charity think about before undertaking an activity or service? (legal requirement)**

Decisions about activities or services must be directed by the charity's objects, and should follow its mission and planned priorities rather than funding opportunities. Funding considerations may well be a factor, but they should not drive or determine the mission.

The trustees should consider the following questions when considering any activity or service:

- Is this activity consistent with the charity's objects and powers?
- How does it fit in with the charity's mission and any specific aims or objectives within our current work plan?
- How will it meet the needs of the charity's beneficiaries?
- How will it be funded?
- Has the charity fully assessed the risks and taken steps to mitigate them?

Trustees should remember that public authorities procuring public services may lack awareness of the objects of the charity or the trustees' legal responsibilities. Charities can encourage finance and other staff of public authorities to take advantage of any training or information services available to them, for example CIPFA-qualified finance staff in the public sector can access the expertise of the CIPFA Charities Panel.

## 6.4 Can a charity's mission or objects be updated, and could we change the objects in order to deliver a particular service? (legal requirement)

It is likely that a charity's mission will evolve and change over time in response to changing needs in society. The trustees should periodically review the charity's objects and mission, to ensure that they are still appropriate.

Updating a mission statement is a policy decision that the trustees may take (but the mission should continue to reflect the objects). Changing the charity's objects is a legal process. The provisions in the governing document, the law and the commission's powers must be followed as appropriate. This is explained in other guidance from the commission including **Changing your charity's governing document (CC36)**.

If the commission's approval, consent or legal authority is required, it would not normally authorise a change if the 'only' reason for making it was to secure a particular funding agreement. A charity's objects and mission should direct its funding strategy, not the other way around.

## 7. Guard your independence

Independence goes beyond the legal status of an organisation: safeguarding independence should be an ongoing activity. Trustees must always exercise independent judgement and properly manage any conflicts of interest. This is particularly important for charities that deliver public services, where public authorities may seek to influence or direct the charity's decision making. There is also a risk that the general public may perceive the charity to be compromising its independence if it receives funding from a public authority. There are steps charities can take to ensure that independence is not compromised.

### 7.1 How can charities stay independent and manage conflicts of interest?

#### The short answer (legal requirement)

In carrying out his or her responsibilities, a trustee must act solely in the interests of the charity. A trustee is not a delegate or representative of any appointing or funding body. It is essential that all trustees understand their legal duties. Where necessary to safeguard the interests of their beneficiaries, charities should exercise their independence and explain its importance to service commissioners and funders.

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#### In more detail

Good governance: charity trustees and managers should follow good practice in governance. New trustees should receive suitable induction and training. Conflicts of interest should be identified, recognised and managed, and decision-making processes should be accountable and transparent. Charities should consider the code of governance for the voluntary and community sector.

The Compact: the Compact recognises the independence of charities and other voluntary organisations from government, and their right to exercise that independence irrespective of funding. In Wales the Voluntary Sector Scheme also recognises the independent nature of the sector. All public authorities should acknowledge and adhere to these principles.

Managing conflicts of interest: a conflict of interest is any situation in which a trustee's personal interests, or interests that they owe to another body, may (or may appear to) influence or affect the trustee's decision making. Trustees should refer to the commission's guidance on **conflicts of interest**.

Where a public authority is trustee of a charity in its corporate capacity this can create particular conflicts. Any funding agreement between the authority and the charity would constitute self-dealing and the funding agreement may be open to challenge unless it has been authorised by the court or the commission. The commission would need to be satisfied that the charity had put in place mechanisms to manage the conflict of interest, and that the proposed arrangement was in the charity's interests.

Contractual terms and conditions: in some cases, public authorities seek to include conditions in funding agreements that might cause the trustees to act in breach of trust or restrict their ability to act solely in the interests of the charity. These could include rights to nominate clients or beneficiaries, to appoint trustees or to send representatives to trustee meetings. They may also include equality and diversity requirements that affect trustee appointments or the ways in which beneficiaries are selected.

Whilst it is understandable that an authority will want some control over the delivery of its services, the charity must not accept any terms or conditions that are contrary to the terms of the governing document (for example, the mechanisms for trustee appointment). The trustees must not surrender their discretion, and must not restrict their discretion unless they are satisfied that it is in the charity's interests to do so.

Saying no: charities should not feel obliged or compelled by their funders to deliver public services, or a particular service. It is for a charity's trustees to decide what activities the charity should undertake, and that decision must be based on the interests of the charity and the needs of all its beneficiaries. Such a decision may, of course, be more difficult if the charity is considering renewing an existing contract where beneficiaries are already in place.

Independence is explained in more detail in the guidance **The independence of charities from the state (RR7)**.

## 7.2 If a charity delivers public services, can it still campaign?

### The short answer

Yes, subject only to the rules and restrictions that apply to all charities.

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### In more detail

Charities that deliver public services should not feel inhibited from engaging in political activity or campaigning; the same rules apply to all charities, regardless of whether their activities are related to public service delivery or not. These rules are explained in the guidance **Speaking out – campaigning and political activity by charities**.

A charity should not be dissuaded from campaigning or seeking to influence public policy on matters where the trustees believe that it is in the beneficiaries' interests to do so. It may also be important in terms of public perception and confidence for the charity to demonstrate that it can exercise its independence by voicing its opinion.

## 8. Know your worth

Charities should be fully informed about the financial aspects of public service delivery.

### 8.1 What does the commission mean by 'know your worth'?

#### The short answer

By 'knowing your worth' it means:

- understanding the full cost of the charity's services
  - recognising the charity's scope to deliver and any limitations
  - identifying any unique or distinctive qualities of the charity's services
  - using these and other relevant factors to set a price for those services
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#### In more detail

The cost of a service: the full cost of a service includes both its direct costs and also the indirect costs (sometimes called overhead, administrative or 'core' costs) associated with it. Core costs include the share of management costs (such as senior staff time and board meetings), research and development costs (including training) and other support costs (including premises and utility costs) that can be fairly allocated to the service.

Charities should know the full cost of any service they deliver or plan to deliver.

By knowing and understanding their full costs, trustees can make more informed decisions about whether to undertake particular services or accept offers of funding.

Recognising the charity's limitations: it is important to know the limits of the charity's capacity. The charity should not take on services, projects or activities that it will be unable to deliver or complete.

Unique or distinctive qualities: charities may have unique or distinctive qualities giving them the potential to provide enhanced services. Such qualities might include specialist knowledge or experience, the charity's ethos (for example, being user-led), or innovative approaches to service delivery. (These qualities are often described as 'added value'). Where a charity identifies such qualities, this should inform the charity's thinking:

- in evaluating whether delivery of a particular service would be an effective way of the charity furthering its objects (and mission)
- in calculating the full cost of delivering a service (including costs of providing a higher quality or level of service), and setting a price that reflects the charity's 'unique selling points'
- in deciding whether it would be in the interests of the charity and its beneficiaries to undertake delivery of a service at less than the full cost

Pricing a service: Besides the full cost and any distinctive qualities, other factors that the commission advises trustees to consider in pricing a service include any particular risk factors (for example, new services and shorter contracts might need to be priced to compensate for potentially greater levels of risk), their relationship with the commissioning authority, the strength of the charity's name or brand, and the competitiveness of the market.

It is perfectly reasonable for a charity to earn a surplus. As highlighted in The Reform of Public Services: the Role of the Voluntary Sector (NCVO, 2005), when it is in the charity's interests to do so, the price of a service can be set to make:

- a full recovery of the cost of providing it
- a surplus to reinvest in the charity's ongoing work
- a calculated loss (subsidising the service)

## 8.2 How can charities understand their full costs?

There are a number of resources on full cost recovery that are available to charities, including costing models, training and advice.

- Acevo's Full Cost Recovery toolkit can help charities to allocate core costs in a way that is compatible with the rules that apply to public sector finance.
- Annex A of the Treasury's Guidance to Funders contains examples of costs that are likely to be incurred in providing services.
- A number of organisations, including Acevo, provide training on full cost recovery.

Trustees should understand the nature of the service to be provided and the way that costs work in order to ensure that the contract is well managed. For example, some costs may vary directly with the level of service use; others may be fixed or semi-fixed and less affected by changes in service use. A full understanding of costs, including the operational drivers lying behind them, is essential to inform business planning, tendering and budgeting processes.

## 8.3 When should charities expect and negotiate for full cost recovery?

The short answer

Charities should expect and negotiate for full cost recovery in any case where a public authority is purchasing a service from them, unless the charity decides it is in its beneficiaries' interests to forego full cost recovery.

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### In more detail

Different types of funding agreements: the terminology used to describe funding agreements can be very confusing and imprecise. There are important differences between the different types of funding agreement. These differences are legally complex, but for the purposes of this guidance:

- A grant is a gift or donation. The donor has no right to receive anything in return, but may attach terms and conditions specifying how the grant is to be spent, which could make it a restricted fund within the charity's accounts. Spending the grant on anything else would be a breach of trust. Any surplus funds will be subject to the same restrictions unless the terms of the grant stipulate otherwise.
- A contract is a legally enforceable agreement between two (or more) parties where one party agrees to provide services in return for payment. A payment under a contract is a fee not a grant, and is subject to VAT (see section 10.3). Any surplus under a contract is not a restricted fund, but might be subject to contractual terms and conditions.

- Service level agreement (SLA) is not a legal term. A SLA is usually a document setting out the understandings of the public authority and the charity about the service to be provided. It would only be a contract if it fulfilled all the legal criteria for a valid contract, including that both parties intended it to be legally binding.

Purpose of the funding: it is important for charities to understand the purpose of the funding. In many cases a public authority will want to obtain (purchase) a particular public service. In such cases, the funding agreement is likely to specify terms and conditions.

A public authority may also provide funding by way of donations to support charitable activities that it recognises the value of, perhaps because they support the authority's wider community objectives.

Application of full cost recovery: the undertakings for the government in the Compact recognise that when charities apply for funding they can include appropriate and relevant overheads.

Charities should plan and budget to recover their costs in full in any case where a public authority is purchasing a service from them, unless the charity decides to forego full cost recovery.

## 8.4 What if the funding offered will not cover the full cost of a service that a public authority is purchasing? (legal requirement)

### The short answer

If a charity is either considering taking up, or renewing, a funding agreement for public service delivery where the funding on offer will not cover the full cost of the service, it can:

- negotiate for more funding
- offer a lower level of service commensurate with the funding on offer
- decide to use other funds to make up the shortfall
- reject the funding agreement and not deliver the service

The trustees' decision must be based on the interests of the charity and the needs of its beneficiaries.

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### In more detail

Trustees must not agree to use any of the charity's funds unless they are satisfied that it is in the interests of the charity and its beneficiaries and fully in line with its objects. Any decision to subsidise or supplement a service must be made by the charity and should not be imposed on it as a condition of funding.

Before deciding to use any of the charity's own funds either to subsidise or enhance a service, trustees should consider the following questions:

- What level of legal duty does any public authority have to provide the service in question? Is there an absolute legal duty (with no discretion over the level of service to be provided); a legal duty but with discretion over service levels, or is the service purely discretionary?
- Would delivering this service be a proper and effective use of the charity's resources?
- Would it be an effective way of helping the charity's beneficiaries?
- What value would the charity add, or what enhancement would it provide to the service by using its own funds in this way?

- In some situations, charities may be able to obtain additional funding or resources that would not normally be available to a public authority. Where such resources are available, charities should aim to use these to achieve genuine enhancements in services for beneficiaries. Public authorities should not assume that charities are automatically able to obtain additional funding or that 'added value' means a higher specification of service at no additional cost.
- In those circumstances where a public authority has an absolute legal duty to provide a service and no discretion over the level of service, there would have to be very clear justification in the interests of the charity for subsidising the service.

## 8.5 Can charities make public authorities comply with the Compact (or the Voluntary Sector Scheme in Wales)?

All government departments are expected to comply with the Compact or the Voluntary Sector Scheme (as applicable). Most local authorities now have local compacts in place, mirroring the terms of the national Compact and VSS. The principles in these agreements should underpin any relationship between a charity and a public authority, and the commission therefore recommends that charities familiarise themselves with, and make use of, these documents.

These agreements are not legally binding, but many of their principles are enshrined in government policy or public law. The Compact has been successfully used in public law cases, and helped in the settlement of legal disputes. Charities may be able to get help and advice about breaches of the Compact from the Compact Advocacy Programme (details from NCVO) or from WCVA on breaches of the VSS.

## 8.6 How could a charity go about identifying or enforcing a public authority's legal duty?

### The short answer

It can be very difficult in practice to identify exactly what legal duty a public authority has to provide or fund a particular service, but a charity can ask for clarification of an authority's responsibility. There are certain steps charities could consider taking to enforce such a duty.

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### In more detail

Because public authorities may provide services under an absolute legal duty, a legal duty that gives them discretion over the level of service, or a discretionary (optional) power, a precise statutory duty can be difficult to identify.

It would be reasonable to ask an authority for written clarification of what duty it has to provide a service, or what funding is available for that service. If necessary, a request could be made formally under the Freedom of Information Act 2000 for copies of any information the authority has on their duty. A charity could also seek independent advice on the authority's legal duties, although this would involve legal costs.

Where a charity identifies that a service affecting its users is not being provided to the required level out of public funds, it may consider whether anything can reasonably be done to persuade the public authority to provide funds to fill the gap. The charity could, either alone or with other organisations, try to negotiate with the public authority for additional funding.

It is acceptable for charities, provided they act in accordance with their objects, to apply legal, political or administrative pressure to secure for their beneficiaries an improved level of public funding for the service in question. The commission recommends reading the guidance **Speaking out - campaigning and political activity by charities (CC9)** if a charity is considering exerting political pressure to improve public funding.

There are also a number of legal remedies that charities and their beneficiaries could consider, including judicial review of a public authority's decision, or bringing a case under the Human Rights Act 1998. A charity may also wish to help a beneficiary to bring a case where the beneficiary does not have the financial resources to do so otherwise and the charity is satisfied that this would be an effective way to further its charitable purposes. Legal action should not be undertaken lightly or without first taking professional advice.

Unless trustees obtain prior authorisation from the commission to use charity funds to meet the costs of legal action, there is a risk that they may become personally liable for these costs. Trustees should therefore consult the commission before commencing legal action. Charities should also bear in mind that there are deadlines for bringing legal action.

## 8.7 What if a charity's governing document prohibits subsidising statutory funds? (legal requirement)

The short answer

Charities must not take any action that is expressly forbidden by their governing document. If the trustees believe that a particular power or restriction is preventing the charity from carrying out its purposes, they should consider amending the governing document. As mentioned in section 7.4, the commission can advise charities about and, if necessary, authorise amendments.

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### In more detail

Express prohibition: some governing documents expressly forbid the charity to relieve or subsidise statutory funds. (This may be expressed in positive terms such as 'shall not'.) Such a prohibition must not be ignored; trustees must understand exactly what is prohibited.

What is permitted? In any case where the charity was providing a service on terms of full cost recovery, there would be no difficulty. If the charity was not receiving full cost recovery, the trustees would have to be clear about what level of legal duty the funding authority had, and whether the level of funding fulfilled that duty. If the authority had an absolute duty, the trustees would need to consider whether the governing document permitted the charity to subsidise statutory funds.

Amending governing documents: most modern governing documents contain a power of amendment setting out the amendment process. Amendments to key clauses, such as the objects and other clauses affecting how charity assets are used, may require the commission's prior written consent or approval, or may be prevented altogether.

The commission has power to authorise some changes that charities cannot undertake themselves, but it would have to consider any request from a charity according to the particular circumstances and the charity's interests. This is explained in the guidance **Changing your charity's governing document (CC36)**.

## 9. Guidance for charities that give grants

Some of the underlying principles of this guidance can be applied to charities that give grants, but there are other issues for these charities to consider. They do not generally provide services themselves or obtain funding from government. They might, however, receive requests for funding, either directly linked to the provision of public services or facilities, or from another charity or organisation that is involved in public service delivery.

### 9.1 What issues should grant-making charities consider?

#### The short answer

In considering applications for grant funding, the commission recommends that charities:

- consider the full range of reasonable grant making options
  - ensure that decisions are based on the law and the interests of the charity
  - use their experience of what public authorities have funded in the past
  - ask questions and challenge assumptions about what public authorities are prepared to fund or have a duty to fund
  - use such considerations to inform the development of their grant-making policies
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#### In more detail

Application of legal principles: the same key legal principles apply to grant-making charities. There is no legal bar on charities using their own funds to subsidise or supplement public services, but they must only do so when it is within their objects and powers, and in the interests of the charity and its beneficiaries to do so.

Charities should generally expect public authorities to fully fund the cost of services that they purchase, and in particular to fully meet the cost of statutory obligations. Therefore, grant-making charities should only be asked, and should only agree, to subsidise public services or other public provision when there is clear justification for doing so.

Past experience: the charity could consider whether the service in question is a new service. If not, who provided it in the past, and what level of service did public authorities fund?

Duties of public authorities: it may be possible to find out whether a public authority has a duty to provide this service, what minimum level of service is the authority required to fund, and what level of statutory funding is available. As explained at section 9, the most practical way to do this may be to ask the authority. Such a request could be made in writing, and could be made under the Freedom of Information Act if necessary.

Setting policy parameters: it is for the trustees to decide the priorities and parameters within which their charity will make grants. As with many other aspects of defining grant-making policy this may involve prioritising some potential beneficiaries over others. It may also involve considering short term and longer-term priorities and funding needs.

Some grant-making charities are concerned that there is a risk of public authorities becoming reliant upon additional charitable funding in the long term, or that the ability of grant-making charities to fund additional or innovative provision may be diminished. These are factors that trustees may choose to take account of in setting grant making policies.

## 10. Other issues to consider

Much of the debate about public service delivery focuses on funding, but there are other issues to consider, particularly in relation to managing risk and maximising effectiveness.

### 10.1 What other steps can charities take to manage risk?

#### The short answer

There are certain steps that charities can take to manage some of the risks associated with public service delivery, including using the form of a limited company, insurance, or delivering the service via a trading company.

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#### In more detail

Incorporating the charity: if the charity is unincorporated (a trust or an association), then any contractual liabilities would fall on the trustees personally rather than on the charity. The trustees of any unincorporated charity that is considering public service delivery should first consider establishing an incorporated structure.

An incorporated structure will usually be that of a charitable limited company. The advantages of the company structure are firstly that it is a legal entity in its own right (the company, rather than the individual trustees, enters into contracts and employs staff); and secondly that, in normal circumstances, the liability of members is limited. It should be noted, however, that incorporation would not protect the charity itself from the financial risks associated with public service delivery. Conversely, there are additional administrative and regulatory burdens.

A new form of incorporated charity, the Charitable Incorporated Organisation (CIO), has been created by the Charities Act 2011. This is intended to provide a more straightforward form of incorporation for charities. The relevant provisions of the Act are expected to come into force from 2012.

Where a charity which is incorporating has a defined benefit pension scheme, it is important to take professional advice and confirm with the Pensions Regulator prior to incorporation, the implications of incorporation on the pension fund. There is additional guidance on GOV.UK: **Defined benefit pension schemes - questions and answers**.

Setting up a separate company: an alternative to 'incorporating' an unincorporated charity is to set up a separate company specifically to deliver a service or services under contract. This is also an option for charitable companies. Using a separate company would enable the trustees to 'ring-fence' the liabilities under the contract by keeping them apart from the charity's other activities and funds. There are costs involved in establishing and running a company, and trustees will need to weigh up whether it is in the charity's interests to transfer an activity to a separate company or keep the activity, and the risk, within the charity.

The separate company could itself be a charity, or it could be a non-charitable trading company. A charity can be set up for and undertake trading which achieves its charitable purposes. It will be required to register as a charity in the usual way. A non-charitable trading company is commonly used to enable a charity to raise funds or trade outside the scope of its objects, for example by providing public services, whether charitable or not, under contract. However, as the company is not a charity itself it will in principle be liable to tax and VAT. Income and corporation tax can be avoided by using Gift Aid to transfer profits to the charity.

The advantages and disadvantages of setting up non-charitable trading companies, and the legal restrictions that charities must observe are complex. These are explained in more detail in the guidance **Trustees, trading and tax (CC35)**.

Insurance: the different kinds of insurance available to charities are explained in detail in the guidance **Charities and insurance (CC49)**.

Contracts often include clauses requiring the charity to indemnify the public authority against third party claims arising out of the provision of the service (for example, if a service user is injured as a result of the negligence of one of the charity's employees). This indemnity is required in order to protect the public authority from claims against it, for example in cases where the charity as provider of the service has been negligent. The trustees also have a duty to safeguard the charity's property. It follows that the trustees should consider the need for the charity to take out public liability insurance, to protect both the charity and the public body.

Some contracts contain very broad indemnity clauses, and this may be a matter on which the trustees need specific advice (see section 5.4).

## 10.2 Should charities consider working together with other charities to deliver services?

There are both benefits and risks associated with partnership or collaborative working between charities. Partnership working can enable charities to compete for larger contracts or benefit from efficiency gains by reducing duplication of administrative functions. This may be of particular benefit to smaller charities. Charities need to be clear about their particular role in any partnership, particularly in terms of shared contractual responsibilities.

The commission has published detailed guidance, **Collaborative working and mergers: an introduction (CC34)**, which sets out the issues to be considered in more detail.

## 10.3 What are the VAT implications of public service delivery?

In general, charities receive no special treatment in respect of VAT on their business activities and VAT registration is required if their taxable turnover exceeds the statutory limit. HM Revenue and Customs produce a range of publications explaining how charities are treated for tax and VAT purposes. Further details can be found on their website [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

## 10.4 What are the implications of competition law for charities delivering public services?

Charities need to be aware that competition law may impact upon public service delivery in certain circumstances. Guidance on competition law is available on [GOV.UK](http://GOV.UK).