

Third Sector Leaders

ACEVO

High Level Report of the
ACEVO Taskforce On Better Regulation:
Public Impact Centred
Regulation for Charities

Kindly supported by

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The Work of the Taskforce: Thanks from the Chair of the Taskforce



Rupert Evenett
Chair, BTCV and Taskforce Chair

This high level report was written between April and June 2010. Evidence was taken specifically for the report from a base of sector leaders and other informed commentators. These helped shape our conclusions and also provided case studies which we have used in the report illustratively rather than prescriptively. These also give texture and three-dimensionality to the conclusions, emphasising their grounding in a practical context rather than an abstract top-down view. A full list of those who gave evidence is set out in Appendix II. We also drew upon a broad base of recent evidence given by ACEVO members to consultations carried out in London and Leeds in October 2009 and March 2010 by Kevin Carey (who became a Taskforce member) and ACEVO staff. A summary of that feedback is set out in Appendix IV.

As noted in the introduction, a lot of detailed work has been and is being carried on by those in the sector and by commentators on it. It would be a significant exercise in itself to list all such work either in hand or done in the last few years. Without offending anyone else, we would note the work done by the Charity Finance Directors' Group, the Charity Tax Group, New Philanthropy Capital's informed research and always strong views, the Cabinet Office's commitment to good regulatory practice of the sector, as well as the Charity Commission itself in its Simplification Plans and implementation and review of the Hampton Principles.

We did not set out to duplicate this detailed work, which carries a different scope of focus, though we have of course benefited from being informed by it where appropriate. Whilst fully embracing the value of this detailed work, the wider horizon is important too. As we note in the introduction, our aim is to shift focus from detailed incremental reform to a broader directional consideration of the purpose of regulation in the sector and what is needed for increased pursuit of public benefit and more robust systems of accountability within the sector. Our aim is to begin a conversation not to end one.

As Chair of the Taskforce, I would like to pay particular thanks to: all my fellow Taskforce members for their generous commitment of time and thought, unflinchingly robust debate and willingness to be chaired; to Kevin Carey for making available his earlier consultation work, to the ACEVO staff both for their help in staffing this report and for the earlier consultation work, to Nick Carey of ACEVO in particular who so ably acted as secretary to the Taskforce, to Stephen Bubb whose idea the taskforce was and who was then confident and generous in setting it up as an independent group reaching its own conclusions, to all those who gave so generously of their time and views in giving evidence to us and without whose contributions our conclusions would have been much the poorer; and to all those ACEVO members who contributed to the earlier consultations. Responsibility for the views and conclusions we have expressed of course remains the Taskforce's and we happily stand by those.

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Executive Summary

The Taskforce calls for a positive vision and rebalancing of charity regulation. Regulation is interpreted here in its widest sense - statutory regulatory and filing obligations, reporting duties to funders and other stakeholders representing accountability, as well as regulatory interpretations internalised by the sector.

This wider regulatory agenda needs to move forward. Consideration of charity regulation has been constrained by excessive attention directed at the micro level and, at times, a sense of ownership by certain bodies of the sector. There is a need for this to change and for the wider rationale behind regulation to be embraced. Particularly given the current political, economic and financial climate, this is an opportune moment to reframe the relationship that regulation has with the sector.

The scale, role and complexity of the charitable sector are rapidly increasing. There is a need for the sector to be as accountable and effective as possible to protect the sector's growing public trust. Furthermore, as Government looks to our sector to galvanise the Big Society, we must ensure that it is not only easy to engage with and hold charities to account, but also that charities are enabled to deliver their public impact as efficiently as possible. We believe that an enterprising, professional and transparent charitable sector is best placed to meet these demands and realise the values of voluntarism and civil society. The sector should therefore be regulated accordingly.

We call for a positive vision of charity regulation, centred on public impact and shared by both regulator and sector. This must be targeted to ensure that charities' aims are in the public benefit (i.e. a solid policing of the boundaries to the charitable sector and the charity 'brand') and that charities are enabled to pursue and maximise their impact in building a more robust, fairer society.

This means a rebalancing of regulation from form to substance and from detailed prescription to effective pluralism. It must free, not stifle, the disciplined passion, organisational strengths and force of voluntarism that we have in our sector. It also means leaders in the sector, its regulators and funders having the confidence and vision to drive effective and enabling change. We welcome the progress that the Charity Commission has made (particularly around outcome reporting – see Appendix III), but we believe it needs to go further with more urgency and energy.

Our vision of efficient and effective regulation is particularly based on more transparent, more informative and more comparable public information. This will enable and encourage tighter systems of accountability and more co-regulation within the sector alongside greater possibilities of innovative social entrepreneurialism. It will free up resources through minimising duplicative tick-box reporting, and encourage organisations to concentrate on how to do better what they already do well. This is high impact, proportionate regulation. It is a 21st century vision of regulation to help build a better society.

This broad report builds on, but significantly differs from, the many excellent pieces of work already in existence addressing individual regulations. We see this as the start of a re-framed and continuing conversation on regulation. We recognise that change does not happen overnight and many of the recommendations will take time to bed down. We advocate incremental change in regulation to change practice as well as culture. Existing structures

within the sector must be used to facilitate this happening. Experimentation and innovation will be important, but where new practices do not work they should be swiftly retracted to prevent regulatory build up.

Our headline agendas are therefore as follows:

The Enterprise Agenda

- This agenda is designed to increase charities' public impact through more effective enterprise activity. It therefore covers recommendations around capitalising the sector, risk management and trading.

The Professionalisation Agenda

- This agenda is designed to rebalance regulation towards a more co-regulatory approach. It therefore covers recommendations around eliminating duplicative regulation, increasing joined up thinking between regulators, changing the regulatory default option on governance structures and increasing the efficacy of sector governance.

The Impact, Transparency and Accountability Agenda.

- This agenda is designed to create a more transparent and accountable sector to reduce the need for top down regulation. It therefore covers recommendations around reducing and standardising regulatory filings, encouraging further use of impact reporting and making a more strategic use of reported data. Responsibility for this lies with sector organisations, regulators and sector funders of all kinds, especially charitable foundations and public sector contractors.

Taskforce Vision

Our **vision** of charity regulation fit for a 21st century sector is one where organisations are enabled to **maximise their public benefit within the boundaries of not-for-profit¹ civil society values**.

It is a vision of **effective pluralism** in the sector where **confident organisations**, internally motivated and externally encouraged, have the **power** to select the most appropriate means to meet their public benefit objectives.

It is a vision of **effective accountability** where charities are held (and hold themselves) to account more extensively for their different public benefit achievements through **public information** that is **open, transparent, comparative and measurable**.

¹ Note here the difference between non-profit and not-for-profit.

Summary of Recommendations

1. The Enterprise Agenda

Overarching principle: The regulatory default option² should be that charities are enabled to pursue a more enterprising approach in realising and maximising their public impact.

Financing: Recommendations for Regulators, Funders & Government

1. Charity Commission guidance should more explicitly endorse methods of capitalising the sector and diversifying organisations' income.
2. Charity Commission guidance should be reviewed to ensure an emphasis on risk assessment and risk management rather than risk aversion which reduces public impact.
3. Charity Commission guidance for trustees and management should be strengthened to include a positive responsibility to consider the potential benefits of mergers, joint ventures and shared property schemes on their public impact.
4. Public service commissioners should consider the impact on charities of the way contracts are tendered and awarded. There should be allocated responsibility within government for reviewing this. Prime contractors should have a similar obligation in respect of their sub-contractors.
5. Charity Commission guidance should encourage boards and management teams of charities to review their financing strategy in order to ensure the financial sustainability of their public impact.
6. The Charity Commission should encourage charities to review their constitutional documents to ensure they are able to adopt financing options they may wish to exercise in the future.
7. "Co-investment"³ should be encouraged by Charity Commission guidance

Recommendations for the Sector

8. The concept of "primary purpose trading" should be better understood to reflect that social enterprise trading and charitable operations now overlap significantly in delivering public benefit.
9. Where applicable, charity boards and management teams should ensure their governance arrangements have oversight of the whole group and all the activities encompassed by the charity's brand.
10. Charities should review their constitutional documents to ensure they have the powers for trading activity in the future should it become appropriate.

² i.e. the default stance of the regulator

³ A policy of two or more funders funding together or using funding from one source to bring in matching or supplementary funds from another source

II. The Professionalisation Agenda

Overarching principle: The Charity Commission should see leading and shaping the sector's public impact culture as a cost efficient source of high impact regulation. This should be achieved through support for professionalism, proactive guidance and a vision for the sector.

Recommendations for Regulators, Funders & Government

1. Regulators, Government and the sector should agree a system to identify and eliminate duplicative regulation.
2. The regulatory default option on governance should be that charities are best placed to determine the most appropriate board structure to meet their mission, providing it is publicly disclosed.
3. Work should be undertaken to understand and address the blocks stopping employers (from all sectors) from recognising the benefits of and encouraging their employees to serve on charitable boards.
4. There needs to be greater use of professional standards and greater recognition of the benefits of co-regulation within the sector. A greater use of peer review mechanisms, particularly for reporting impact, should also be explored.
5. A significant new area of regulatory duplication for charities proposed by recent HM Revenue and Customs (HMRC) rule changes should be urgently re-thought and avoided.

Trading: Recommendations for the Sector

6. Charities should ensure their constitutional documents have the power to exercise different governance options in the future should they become appropriate.
7. There should be greater sector investment in board recruitment and training. The idea that serving on a charity board is personally and professionally fulfilling should also be better promoted.
8. Charities should review, update and disclose the impact of their practices and plans for investing in the quality of their governance structure.

III. The Impact, Transparency and Accountability Agenda

Overarching principle: To increase accountability we recommend that the publication and regulatory filing of sector information should be radically reformatted, streamlined and made more transparent. This will allow greater co-regulation and a more practical public analysis of charity effectiveness.

Recommendations for Regulators, Funders & Government

1. Duplication in regulatory returns should be abolished and the number of different returns should be reduced. The Commission should amalgamate the Annual Return with the Annual Report and abolish the Summary Information Return.
2. Regulators and funders should accept and encourage reporting standardisation and work with charities to achieve this.
3. The Charity Commission and Government should procure investment to research impact reporting with the aim of creating a more transparent sector which requires less top down regulation.
4. There should be more focus on sectoral information and comparisons being made possible to bring clarity to the sector and enable a more high-impact, low-frequency style of regulation to flourish.
5. Regulatory data should be uploaded, publicly available and accessible in searchable data form rather than as scanned documents or PDFs. Such public information should be freely available for all analysts.

Recommendations for the Sector

6. Charities should look to consolidate and standardise the information they produce for funders and regulators to reduce the time spent on reporting.
7. Charities should refocus their reporting style towards a more candid appreciation of targets set, performance achieved and an acknowledgement of where and why performance has differed.
8. Social enterprises which are not charities and are not therefore subject to the same regulation should consider the same informational/performance reporting recommendations and build them into their own practices.

Introduction

The voluntary and social enterprise sector is rapidly evolving and addressing a large and growing public need. It is therefore important to ensure that the regulatory framework within which it operates is fit for purpose and kept up to date. The argument presented in the following pages is a positive vision of focus and mutuality within charity regulation. An increasingly professional, transparent and enterprising sector that reports its public impact⁴ more effectively requires less top down regulation. This is currently particularly pertinent as regulators are facing budget cuts⁵ whilst the role of and demands placed on the sector are increasing. Given the further responsibility placed on the charitable sector to deliver savings through socially productive public services, the need to reform charitable regulation cannot be underestimated.

The charitable sector exists to deliver public benefit⁴ without distributing a surplus. We therefore believe that its regulation should also centre on public benefit. Regulation is a necessary part of being a charity and delivering public benefit – this report is not about “light touch” or burning regulation.

This taskforce report is therefore written in support of the crucial role of regulation and some of the interesting directional work being led by the Charity Commission,⁶ amongst others. Our recommendations do not only address the Charity Commission but also other regulators, Her Majesty's Revenue and Customs,⁷ Government and, not least, the sector itself (since internalisation is an important source of regulation). We believe the Charity Commission shows leadership and proactivity in some interesting areas, but there are further changes which we would want to see in the regulatory framework to drive increased public impact. However, it is a fact of organised human life that regulation, once institutionalised, can be hard to revise and keep fresh. As in other aspects of institutional life, rule and procedure can inadvertently acquire a life or influence beyond the explicit intentions of any person currently responsible for them.

It is also often too easy to add new rules and not remove those no longer filling a sufficient purpose. This is why a hard rule of “one in, one out” can be so helpful when adhered to alongside a regular review of regulatory applicability and impact.

4 The term ‘public benefit’ is used by this report in a broader context (i.e. what the charity delivers) than the meaning of the concept as outlined through Charity Commission guidance. The term ‘public impact’ refers to the positive effect an organisation makes on the public by delivering its mission, i.e. a charity’s public impact is a function of delivering its public benefit.

5 See, for example, *Sixty Jobs to Go at Charity Commission by Next March* (Third Sector, 19th May); accessed at: <http://www.thirdsector.co.uk/News/DailyBulletin/1004424/Sixty-jobs-go-Charity-Commission-next-March/FB0CB58E17D4814A1C66AAF21A953180/?DCMP=EMC-DailyBulletin>

6 For the sake of focus, we address ourselves in this report to England and Wales and by the Charity Commission therefore refer to the Charity Commission for England and Wales and not the Charity Commission of Northern Ireland. We support the institutions and work of OSCR in Scotland and the Charity Commission of Northern Ireland, believe that much interesting work is being done in those bodies, which again reflects the benefits of pluralism and of public policy that is sensitive to local context, and do not make or imply any statement by restricting our focus. In any event, we believe that our comments are for the most part struck at a level which would be relevant and applicable across multiple jurisdictions.

7 The role played by HMRC in regulating the sector must be fully understood. They are the only cross-UK body to hold charity records and the impact of HMRC compliance (see particularly recommendation 9 in the Professionalisation Agenda and work performed by Charity Finance Directors’ Group – CFDG – and the Charity Tax Group – CTG) on organisations is very significant.

The aim of this report is to re-articulate the positive guiding purpose and desired outcomes of regulation in our sector, within its existing legislative framework.⁸

There are essentially four levels of charity regulation in England & Wales based within the existing legislative framework:

- a. Primary legislation – e.g. the Charities Acts 1993 and 2006
- b. Secondary legislation (salutatory instruments) – e.g. the Charities (Accounts and Reports) Regulations 2008
- c. Regulatory requirements which are made by the Charity Commission, for example the Directions to Independent Examiners or the Annual Return regulations) and Directions and Orders made to individual charities
- d. Other policies and guidance issued by the Charity Commission seeking to apply the law and to guide the sector in terms of practice.

This report outlines a vision for effective regulation of a 21st Century charity sector - which in turn can sustain a confident, transparent, accountable, public benefit focused sector. In developing our themes, we make specific priority recommendations which would significantly contribute to the sector's regulatory health, and its growth as a vehicle of increased public benefit.

We first set out the Background – why now and why regulatory change is a priority – then our overall Regulatory Philosophy, focusing on pluralism and public benefit. We then outline our more specific Recommendations.

We have taken evidence from a wide variety of sources within the sector for this report which has critically informed our conclusions. We have also been able to make use of a sampling of ACEVO members' views. This report endeavours to be a more bottom-up than top-down report – practitioner-based and from those struggling with some of the barriers to success in achieving public benefit. It is recognised that some of the ideas contained in this report have already been partially explored. However, this review seeks to re-frame the relationship between regulation and the sector rather than address specific regulations. The consolidation of ideas and reframing of regulation within this report generates a powerful argument to re-examine those ideas as constituent parts of a broader review of regulation and the charity sector.

A new government is a good time to be considering regulatory shape. Given social priorities and economic circumstances, many sectors are reconsidering the shape and purpose of regulation. The conclusions and recommendations here are a constructive response to priorities and issues in our sector. Even if the result is different answers, we hope that Government, regulators and the sector itself will debate the important questions raised. As a sector we are accountable to the public, and the public deserves nothing less than the most effective and accountable sector.

⁸ One guiding principle for us has been to avoid any argument for new legislation. Our argument is about regulatory interpretation, emphasis and practice within existing legislation. It should be noted, however, that this report also discusses quasi regulatory obligations (such as reporting to funders) as well as regulation which has been internalised by organisations.

Background: Why Now?

Our sector, in all its names and sub-sectors⁹ occupies a special and unique place in the UK's public life. It fulfils a range of important roles including bringing people together, addressing public need, enabling self-help, delivering effective public services, advocating and campaigning. Primarily a means and not an end (i.e. enabling, not being the good society itself),¹⁰ it aims to change society for the better, not merely reflect it.

Significant current issues addressed by our sector add necessity to increase the sector's impact – reducing inequality, reconnecting citizens to society's life chances, reforming public service delivery, reconnecting ourselves with our shared environment and practically addressing climate change. This is made all the more pressing by a large public sector deficit which the sector has an important role in reducing as well as the fundamental position the sector holds within the new Government's Big Society agenda.

As a result, it is now both timely and critical to review the focus and effectiveness of regulation in our sector. Regulation helps define our sector. Like good education it needs to discipline and motivate without handicapping or stifling that which it seeks to nurture.

The scale of public need in society that our sector can address is huge. The current state of public finances, which are likely to experience more than a short term cyclical downturn, means that the state will do less.¹¹ Our sector will need to fill the gap left and meet the rising demand. Given the scale of opportunity for our sector to increase its public benefit impact, the level of necessary funding will not be able to come from traditional charitable sources alone (even assuming a much sought for transformation in individual high net worth philanthropic giving in this country or a cyclical recovery in corporate finances allowing corporate social investment to achieve higher levels).

Entrepreneurialism and innovation are already hallmarks in many different ways of our sector and are strengths we need to play to. The combination of increased demand and insufficient traditional funding means that social enterprise in the broadest sense will have to fill the gap. Public need will otherwise go unmet and our public impact will go unoptimised. Social enterprise¹² in the best sense is not just about funding structures and diversifying sources of income but is also about the means of reaching beneficiaries in different and innovative ways. This means that a regulatory approach to charities must take account of social enterprise.¹³

Not all social enterprises are or should be charities,¹⁴ but nearly every charity¹⁵ now has to be at least in part a social enterprise as part of its core purpose. Any charity that has not considered the contribution that social enterprise could make in achieving their mission

9 In this report, we avoid the rather theological debates on what the sector should be called

10 Though there is an academic view that civil society is the good society

11 Although this is not to prejudge where the boundary between state and civil society is or should be

12 For the purposes of this report, social enterprise is defined as trading for a social or environmental purpose, where profits are reinvested into the organisation or their community

13 Which is very different from saying that social enterprises should be regulated in the same way and to the same extent, for which there is no justification and which is not our argument

14 And new social entrepreneurs who would once have set up charities may now instead set up social enterprises that are not charities and are not subject to the same level of regulation. As a result, social enterprises may come to do more of what charities would once have done

15 Particularly those charities that deliver products or services. Funders should also be more socially enterprising in driving up charities' public impact by ensuring they work both their capital and interest as hard as possible; for example using Programme Related Investment

more effectively is likely to have missed a significant opportunity. This is part of a wider theme to appreciate the role and need for a wider range of organisational structures for achieving social and economic outcomes. Both the public and private sectors are going through their own reassessments of structures and organisational pluralism. The space between “the state” and “the market” that we occupy, though, already has the benefit of plural organisational structures – in both type and scale.

Our sector ranges from local to international charities, from delivery to advocacy charities, from purely volunteer organisations to social enterprises, each delivering and measuring their public impact differently and often combined in the same charitable “group”. This is not to advocate pluralism for pluralism’s sake, but is recognition that a diverse need requires an aligned, diverse range of organisations to meet it most effectively.

And as we all know, to those whose life-chances are affected, the most local public good of a strong community can be more important than a more abstract public good. So such diversity of organisations and the rich, mixed ecology of our sector are to be cherished and sustained; all the more so as it is an area where our sector is ahead of others.

And our sector is growing. As in all sectors, scale of activities and size of income are not ends. At best they are an indirect measure of success in meeting targeted outcomes. Our social outcomes are what matter – but we should note that the scale and sophistication of the sector in effective pursuit of those outcomes has increased dramatically over the past ten years. The sector now has a financial income of some £157 billion¹⁶ and directly employs 1.6 million people¹⁷, even before we add in our vast and dedicated army of volunteers.

Effective regulation for our sector in the 21st century needs to face up to these factors. Regulatory priorities and practices devised for simpler contexts or just different times need to be reviewed. In a sector where demand is large and growing, where new means of delivery are rapidly developing (most notably social enterprise) and where sources of finance are under pressure, it should be no surprise that regulatory practice needs a fresh look.

The new regulatory practice must ensure its boundaries protect the values of the sector – we exist not for profit but to serve and grow the public benefit. Within those boundaries, however, prescription needs to be able to co-exist happily with a bold, liberal and pluralist sector which focuses on maximising its public benefit.

¹⁶ NCVO Almanac 2010; this figure is bigger than that of the car industry

¹⁷ *ibid*; this figure is bigger than that of the banking and finance sector

Regulatory Philosophy: Key Principles and Vision

We support the Hampton principles for effective regulation.¹⁸ In a resource and cost constrained world the principles of **non-duplication**, and a **risk-assessment based approach focused on outcomes**, not inputs, will yield significant savings for the sector without diluting the regulatory benefits. We believe an increasingly professional, transparent and enterprising sector requires less top down regulation. As a key principle, **any unnecessary diversion of cost or time takes away from our sector's public benefit outcomes**. In addition, in applying practitioners' principles of effective regulation to our sector, our regulatory philosophy derives three further general principles.

Firstly, we believe that the **logic of the public benefit focus**, now enshrined in legislation, should be followed through. Within the regulated boundaries of a public benefit focus with civil society values, organisations should be free to select the institutional means that they believe will deliver their most effective public impact. Organisations must therefore take responsibility for reasoned public disclosure of what they are doing as part of their overall public benefit mission reporting.

Regulation should be designed to maximise the public benefit of organisations within this sector. There is a significant difference between the current situation and what we advocate. The current default option is "no", but with a possible "yes" if an organisation is prepared to invest time and resources. We want to see a mindset where the default regulatory option, within the sector boundaries, is "yes" as long as there is a fully reasoned public disclosure. Too much energy is tied up in issues that charities should have the power to decide and be accountable for themselves.

Secondly, we believe that the **logic of pluralism and of civil society organisations' authority** deriving from their proximity to the public need and their beneficiaries should be followed through. That authority means charities are best placed to determine institutional detail as long as their reasons are public and they can be challenged. Transparency is usually a great remedy and preventative of abuse. Indeed, John Stuart Mill pointed out that we need "plural experiments in living"¹⁹ as individuals and as a society. To put the point in technical terms, the epistemology of public policy is inadequate without pluralism. Without different organisations pursuing different aspects of public benefit using different means, we would not know what produces the best outcomes. Overly prescriptive or disproportionate regulation reduces this pluralism and our knowledge of maximising public benefit.

18 The Hampton Principles (2005) support transparency, non-duplication and a proportionate, risk-assessment based approach focused on outcomes. They are: (1) regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most; (2) regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take; (3) no inspection should take place without a reason; businesses [organisations] should not have to give unnecessary information, nor give the same piece of information twice; (4) the few businesses [organisations] that persistently break regulations should be identified quickly; (5) regulators should provide authoritative, accessible advice easily and cheaply; and (6) regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection. [Accessed from <http://www.bis.gov.uk/policies/better-regulation/improving-regulatory-delivery/assessing-our-regulatory-system>]

19 And to give more recent authority, the modern political philosopher John Rawls, the father of the contemporary philosophy of social justice, based his account of the "the facts of reasonable pluralism". Reasonable people reasonably disagree. No one has a monopoly on the details of what is publicly justifiable or in the best public interest.

Thirdly, we believe that the **regulatory culture of the sector** needs changing in the way that it is promoted by the Charity Commission and in the way it is **internalised** by charities. At the moment there is a law-and-compliance culture resulting in risk aversion.

Some of this culture is well pitched in guidance and in case reviews, with a justified emphasis on, for example, protection of charitable assets. But aspects of the culture expressed in routine guidance are also overdone. When someone first becomes a charity trustee, the guidance they receive is over-weighted towards awareness of liabilities, risks and what not to do, rather than on how to get the best out of their charity. The prevailing culture internalised by charities is that compliance with filings and avoiding innovation will discharge best practice.

The effect is that organisations are discouraged from change and a combination of over-regulation with under-regulation. Formal compliance is over-regulated whilst high impact substantive regulation of the sector's impact is under-regulated. Furthermore the lack of clarity in regulatory timetabling for charities discourages a strategic approach to regulation within the sector. For example whilst the Department for Business, Enterprise and Regulatory Reform (now Department for Business, Innovation and Skills) announced specific implementation dates for each stage of the Companies Act 2006 up to two years in advance, the Charities Act 2006 only ever gave vague timescales (e.g. Summer 2008). Timings therefore slipped and many provisions within the Charities Act still remain unimplemented (against the Companies Act 2006 which was virtually fully implemented by 1st October 2009 despite both Acts receiving Royal Assent on the same day).

The Charity Commission should be more robust in encouraging organisations to be strategic, to pursue public benefit as effectively as possible and to measure and report on their progress in achieving public impact. This transparency and frank assessment would allow stakeholders to assess where most impact is being achieved.

This re-balancing of regulation would affect the internalised regulatory culture of the sector. We believe that public benefit is served best when charities are confident, not insecure. Organisations should be confident about being strategic in pursuit of their public benefit and not constrained by either a regulatory checklist or being rash in decision-making because strategic governance is crowded out by compliance.

This is neither about abandoning prudential regulation nor about "heavy vs light touch". The boundary of what a charity can and cannot be and its information publication requirements should be firmly policed. But within that boundary the emphasis should be on substance not form. The aim of the sector is to maximise its public impact, thus regulation should be based around this – not around its means or inputs.

Furthermore, it is necessary to recognise that the Charity Commission and other regulators are not protected from public sector cuts. This means that at a time of a large public need and growing demand for the sector, they will be faced with doing more with less. It is critical that the sector is able to help them maintain their role and not be forced to cut important frontline services (e.g. advice and help) which are highly valued by many charities. It should also be recognised that some of these savings could be realised through consolidating regulators, better sharing of information or increasing levels of co-regulation to help reduce the Commission's burden.

A common theme across these three regulatory principles is the belief that regulation works best when there is a shared sense of purpose about regulation and a mutual sense of responsibility for it between regulator and regulatee. Regulatory culture matters. For all the excellent intentions

and progress of current regulators, we still have a lingering Victorian legal culture in this sector. Cultures are hard to change.

We therefore interpret regulation broadly and are addressing three audiences: Government, regulators (the Charity Commission alongside other regulators with which they overlap), and the sector itself. Government and the Charity Commission share a responsibility to enable and promote the required changes without doing it all themselves. Leaders in the sector have a duty to be conscious about the internalised regulatory culture of both the sector and their own organisations. The most effective form of regulatory compliance is internalisation – when regulatory objectives have become absorbed into the day-to-day values in which the sector operates. This makes it all the more important for organisations to review the internalised regulatory assumptions which may often transcend the explicit regulation. Further exploration of regulation will help organisations break down barriers to increasing their public benefit through innovation and taking calculated risks.

From these principles, we derive our specific recommendations arranged under three agendas which we discuss in the next section:

An Enterprise Agenda

This agenda looks at ways of enabling the sector to become more enterprising in delivering and maximising public impact. Not only is the sector currently undercapitalised (and it is necessary to continue the strong work already being performed in rectifying this), but there is currently a much stronger need for charities to look at more innovative ways of delivering their public impact. There is a need for the sector to adopt a less risk-averse stance and more proactively manage, rather than avoid, risk in order to maximise its public impact. Within this, there is an important role for external bodies (e.g. regulators and government) to promote this approach, as well as an important role for the sector itself in driving forward an internal cultural change.

A Professionalism Agenda

This agenda looks at rebalancing regulation towards a more co-regulatory approach. An increasingly professional sector requires less top down regulation; regulation should take a more strategic approach, eliminating duplication and making greater use of tools such as professional standards and quality marks. This requires both the sector and external stakeholders to take a proactive approach in achieving a regulatory framework centred on this high-impact approach through more indirect methods.

An Impact, Transparency and Accountability Agenda

The previous two agendas are both underpinned by the need for the charity sector to become more transparent and accountable to all stakeholders. This agenda looks at developing and streamlining the systems through which information on the sector is both recorded and presented. This will require a much more strategic approach by regulators to data collection and analysis as well as the sector adopting a more considered approach to its reporting. Furthermore, there needs to be greater investment in impact reporting to create stronger methodologies in demonstrating charitable impact. By opening up and streamlining reporting within the sector, there is strong potential for a more high-level approach to regulation, where regulators (and stakeholders) can take a strategic approach

to holding organisations to account. This will need impetus from inside and outside the sector, but would offer significant long term savings to both if achieved.

The names of these agendas alone will cause an intense reaction among some people and seem to be symbols of a creeping rejection of voluntarism and the sector's long established values. They are of course nothing of the kind.

The voluntaristic and civil society values of the sector are deeply embedded; they are what makes the sector distinctive and continue to command respect. It is precisely to help charities maintain those values and increase their efficacy that we recommend our Enterprise and Professionalism agendas. It is precisely so that the public and other stakeholders can see whether charities are effectively delivering their public impact that we recommend our Impact, Transparency and Accountability agenda. These agendas will strengthen our sector's values and increase its impact.

Recommendations

1. The Enterprise Agenda

Overarching principle: The regulatory default option²⁰ should be that charities are enabled to pursue a more enterprising approach in realising and maximising their public impact.

The test for regulatory prohibition should be a harm principle: such regulatory intervention should be warranted only if there is reasonable expectation that harm will otherwise be done to the public benefit mission and core values of the sector.

An enterprising approach refers to a charity's ability to make pragmatic judgements around (a) what will allow it to pursue its target public benefit as effectively as possible, and (b) whether to undertake trading activities in pursuit of its core mission both as a source of finance but also as a core way of innovative delivery of its public impact and of reaching its beneficiaries.

The principle here is to reduce barriers to creating public benefit as effectively and sustainably as possible. The aim is to enable organisations to secure their mission and values better by being able to be more operationally and financially flexible. We want a more powerful public impact sector.

This follows from our public benefit and effective pluralism principles. Charities need to be able to experiment with new ways of effectively delivering their mission. It also helps address our regulatory culture principle. It also follows from the Hampton principles of allowing organisations to proceed with developing their activity with regulatory intervention only when there is a clear case for protection.

We draw out here two basic dimensions to the overarching principle – relating to Financing (detailed recommendations 1-7) and Trading (detailed recommendations 8-10).

Financing: Recommendations for Regulators, Funders & Government

1. Charity Commission guidance should more explicitly endorse methods of capitalising the sector and diversifying organisations' income.

Charities need more robust and diverse financial platforms as well as deeper sources of longer term capital funding. They need to be able to articulate the strong investment case for our sector where the benefits (including the savings for the public purse) are typically multiple outcomes for each pound of social investment.

A lot of interesting work is being done on new sources of capital for the sector; these should be encouraged by regulators and provided with an overarching regulatory framework. Charity Commission guidance should seek to endorse active financial management and more explicitly explain the limits of trustees' personal liability when using such financial products. The current tone is unduly negative and restrictive which creates an overly risk averse culture.

²⁰ i.e. the default stance of the regulator

The regulatory default option should be that social impact bonds, loans, quasi-equity and other newer long term financing sources are acceptable, even encouraged. Over the longer term, more speculative ideas (like the development of a social stock exchange) should also not have regulatory impediments. Apart from the investment opportunity to deploy much larger amounts of capital and grow the sector's public benefit mission, the sector is also facing a steady and growing trend where grant-type funding is converted to more contractual or outcomes-linked funding (and not just for public service delivery contracts). This greatly increases the working capital needs of the sector as it has to undertake operations in anticipation of achieving outcomes. This double capital need has to be filled and there should not be regulatory silence on it.

Social Finance has strongly advocated that the current Charity Commission guidance on social investment is neither clear nor clearly supportive. They argue that this impacts on the ability of foundations and trusts from using social investment and recommend that the guidance is updated with examples of good practice and guidelines for trustees to follow.²¹

Reframing the guidance will help change the sector regulatory culture on financing and enable more powerful charities to deliver their mission on a more sustainable basis. The aim should of course be a prudent balanced financial structure.

Venturesome has identified four pillars to a robust²² social investment market:²³

1. A confident and informed demand from the voluntary and community sector (VCS)
2. An efficient matching of supply and demand
3. A variety of investment mechanisms
4. A resilient supply of finance

The important role that good providers of capital can play in driving up transparency and governance of organisations should also be noted. This can take place both before and during their relationship through prudent due diligence work and the techniques that capital providers use to manage their investment.

The Social Investment Business

The Social Investment Business is a large social investor providing capital, knowledge and expertise to civil society organisations. They have found a high demand for social investment from across the sector and receive up to £90m of enquiries every month.

The fund of the parent charity, The Adventure Capital Fund (ACF), was independently evaluated in 2009.²⁴ Evidence from this evaluation supported the need for loan financing in the sector: "The ACF Main Investment Programme has demonstrated that there is a demand for loan finance among a group of organisations that hitherto has been reliant on grant funding."

21 Social Finance (2010) *Towards A New Social Economy – Blended Value: Creation Through Social Impact Bonds*

22 Defined as "a world in which informed charities have access to appropriate capital, from a resilient capital supply, distributed using a variety of financial mechanisms."

23 Venturesome (2009) *Access to Capital – A Briefing Paper*

24 *Investing in Thriving Communities: The final external evaluation report on the Adventure Capital Fund* - Centre for Social and Evaluation Research/London Metropolitan University

Loan financing has been found to be a very effective method of capitalising and growing the sector. From the evaluation, ACF investees saw "a 62 per cent increase in income in the three years after they received their ACF allocation, whereas all similar sized registered charities recorded an average of five per cent growth for the comparable time period."

This is combined with a very low cumulative write off rate for the funds managed by The Social Investment Business of just over 3% – especially notable given the un-bankable nature of all of their investments. The ACF evaluation points to 'engaged investing' (through pre-application and ongoing business support) as playing a key role in this.

Venturesome and Interhealth

Venturesome provides capital to charities and social enterprises, operating in the space between providers of charitable grants and providers of bank loans at market rates.

Since its launch by CAF in 2002, £15 million has been offered to 250 organisations. In addition to accumulating practical deal experience, Venturesome has endeavoured to have a central role in building a robust social investment market, adopting an open-book approach to share knowledge and build experience, but also ready to operate in competition so as to raise standards.²⁵

Interhealth provides healthcare and support to many of the major international agencies involved in humanitarian relief and poverty reduction across the world. It is a specialist London-based medical charity, providing medical, psychological and occupational health services.

Venturesome first worked with Interhealth in 2006, when they provided a £40,000 loan to improve IT systems (now fully repaid). In early 2007, the charity had to relocate at short notice, at a time when finances were stretched. Working with Venturesome, a funding plan was agreed, and a further £60,000 loan was provided. Interhealth is now operating from bigger premises that have enabled the charity to expand, partly through generating extra income by renting out spare meeting rooms. Venturesome has since provided a third, standby facility, to support cash flow as the charity strengthens its balance sheet.²⁶

Impetus Trust

The Impetus Trust seeks to break cycles of poverty by investing in charities which work against economic disadvantage. They use a model of venture philanthropy to help accelerate the growth of selected organisations.

Their venture philanthropy model has three key components:²⁷

1. Strategic funding

They give long-term core funding to charities and social enterprises so they can build their capacity. This funding is linked to the organisation meeting pre-agreed milestones, which are tracked on a quarterly basis. In addition, an important part of the Impetus model is that it is often able to leverage our funding with additional funding from co-investors.

25 <http://www.cafonline.org/pdf/CAF%20Venturesome%20Access%20to%20Capital%200909.pdf>

26 <http://www.cafonline.org/default.aspx?page=18872>

27 Adapted from <http://www.impetus.org.uk/what's-special-about-impetus/our-innovative-approach>

2. Hands-on management support

The 'secret ingredient' of the Impetus investment model is the hands-on management support given to the chief executive and senior management of the charity by an experienced, in-house Impetus investment executive. The Investment team members have substantial consulting, financial and voluntary-sector experience, and the investment executive's support spans the entire investment period.

3. Specialist expertise

Impetus has a pool of highly skilled experts, who volunteer their skills to their charities and social enterprises. This expertise is deployed for specific, mutually agreed projects, with the expert and investee organisation agreeing the brief before a project starts. Each project has a defined period of time and objective, to ensure results.

Example projects include:

- Business model review and business planning
- Financial planning and reporting
- Development of performance measures
- Senior management team coaching

City Bridge Trust: Grants and Capacity Building²⁸

The City Bridge Trust makes grants for charitable activity in London and has roughly £15m/yr available for distribution.²⁹

One of the programmes the City Bridge Trust runs is helping small organisations improve their services to older people. The grant (of up to £20,000 for capital and/or running costs) is available to help deliver the service, but organisations also access further funding to improve the service management thereby strengthening and sustaining the organisation itself ('capacity building'). This can be up to seven days bespoke support delivered by a suitably qualified consultant.

As part of the capacity building, the City Bridge Trust is providing funding to meet the costs of consultancy help, expert advice or training on any of the following:

- developing a business plan or work programme
- monitoring and evaluating your work
- improving your management committee through trustee training
- fundraising
- developing financial and managerial systems
- report writing
- using the media to get your message across
- recruiting and supporting volunteers.

2. Charity Commission guidance should be reviewed to ensure an emphasis on risk assessment and risk management rather than risk aversion which reduces public impact.

A charity will reach fewer beneficiaries under a risk averse culture than under a more balanced risk management culture. The right balance of risk assessment will of course depend upon the particular context of an organisation, the nature of its beneficiaries (how dependent, how vulnerable), its managerial resources and its access to and nature of funding streams.

Some of the most significant problems in the sector are inaccurate internalisation of charity regulation and misinterpretation of what being a charity means by trustees. Many trustees internalise too great an emphasis on personal liability and therefore too great an emphasis on risk aversion. Prudent management of risk is of course a core part of a charity board's responsibilities. But this is not to the exclusion of a proper concern with investment, with optimising public benefit impact and taking on risk where it appropriately matches expected social returns. Education and briefing material for new trustees unintentionally reinforces this internalisation. Insufficient emphasis is placed on trustees' holistic responsibilities for optimisation and sustainability of their charity's mission and (if their organisations are achieving that public benefit) for the good health and sustainability of their organisations.

The 2008 CFDG/PFK Survey found that "Compared with other sectors, a disproportionately large number of charities have moderate or low risk appetite, and that many have ongoing success at keeping their risks within their appetites. Although this reduces the chance of financial failures within the sector, such prudence must also be inhibiting the activity of charities. In order to get the best for their beneficiaries, charities need to be bold, fighting for and exploiting opportunities wherever possible. The profile of risk appetite indicates that many within the sector are not doing this, and that by being less risk-averse, charities could do a lot more for their beneficiaries without jeopardising their future."³⁰

Charity Commission guidance should emphasise the duty to invest properly in the public mission, expand and innovate when appropriate and take well judged risks in pursuit of public benefit. A fiduciary duty to protect the assets of a charity does not exist alone.

Zurich Financial Services

Zurich is a global insurance-based financial services provider.

Paul Emery, Head of Community and Social Organisations at Zurich, states "The charity sector still remains overly risk averse. At Zurich, we advocate charities taking and actively managing risk in order to innovate and maximise their public impact. However, to do this successfully, risk management needs to be embedded across organisations and into their cultures. Boards have an important role to play here, but it is vital that the ethos is

28 Based on: <http://www.bridgehousegrants.org.uk/CityBridgeTrust/Grants/GrantsProgrammeGuidelines/Improving+Services+for+Older+People.htm>

29 <http://www.bridgehousegrants.org.uk/CityBridgeTrust/TheTrust/PKFandCFDGRiskSurvey2008-ManagingRisk-AHealthyAppetite>, accessed at <http://www.cfdg.org.uk/cfdg/surveys.asp>

30 PKF and CFDG Risk Survey 2008 - Managing Risk - A Healthy Appetite; accessed at <http://www.cfdg.org.uk/cfdg/surveys.asp>

engrained across the charity. Whilst the principles of charitable risk management scarcely differ from the private sector principles, the awareness and understanding of them throughout the organisation is significantly lower in the charity sector. The situation is improving but coverage is still too patchy.

We are actively trying to address this issue for both our clients as well as the general sector and have released simple guides for risk management in charities. We encourage clients to examine the overall concept of 'operational resilience' as a holistic method of managing risk. This approach examines risks within the organisation, risks in the organisation's supply chain as well as creating a suitable business continuity plan to use if things do go wrong.

Particularly given the current drivers of change within the sector, the nature and scope of risk management is evolving. Increasing numbers of organisations are working together and it is imperative that they fully understand the transfer and split of risk within the relationship to manage it appropriately. Furthermore, given greater charitable presence in public service delivery, charities should factor risk management costs into their bids to ensure Full Cost Recovery."

3. Charity Commission guidance for trustees and management should be strengthened to include a positive responsibility to consider the potential benefits of mergers, joint ventures and shared property schemes on their public impact.

Often thought of as strategic or operational choices, such options are also financing opportunities. Shared costs free capital for generating greater public benefit. Too much capital in the sector is tied up in property when property could be more productively shared. Boards and management teams should be able to justify how such options have been considered. Any charity that has not considered these options is highly likely to have missed significant opportunities to increase their public benefit.

RNIB's Group Approach³¹

When asked to describe the nature of the governance agreement signed in spring 2009 between her charity and Action for Blind People, Lesley-Anne Alexander, chief executive of the RNIB, said it was "somewhere between collaboration and merger".

Although this emerging model can take a variety of forms, their common element is that they are more than a coalition or loose partnership. The RNIB has become the sole corporate member of Action for Blind People as well as the Cardiff Institute for the Blind.

The smaller charities have therefore become subsidiaries of RNIB, thus creating an RNIB Group where the 'junior' partners have retained independent charitable status and their own trustee boards.

The smaller charities have kept their cultural distinctiveness and ability to raise funds as separate entities, but there are limits to their independence. Action for Blind People and the Cardiff Institute have given up the right to determine their own strategy. Instead, they must align themselves to the RNIB's strategy, which itself is based on the UK Vision Strategy, agreed by 600 organisations working in the sight loss field. The board of the RNIB has ultimate authority over the group - Action for Blind People's board reports to it, and

31. Based on <http://www.thirdsector.co.uk/news/Article/949513/charity-partnerships-finding-new-ways-work-together/>

the RNIB appoints half of the board at the Cardiff Institute.

The agreement now means the smaller organisations are able to access RNIB's infrastructure and financial capacity. Action for Blind People has transferred its 27-strong fundraising department to the RNIB which raises funds for both brands. The RNIB has also taken on the investment strategy and cash flow management of the Cardiff Institute.

For RNIB, the benefits of acquiring subsidiary charities are varied. Alexander says the creation of the RNIB Group will reduce duplication in the sight loss sector, which includes more than 700 charities. The RNIB has transferred £8m of grants and contracts, and 276 staff, to Action for Blind People to deliver regional services in England thereby rationalising delivery and maximising group impact.

The group's members vary in size and mission. RNIB is concluding negotiations with National Talking Newspapers and Magazines and is in discussions with two other organisations about joining the group. "We can be a large or small charity," says Alexander. "We can be close to people or nationally campaigning. RNIB Group brings lots of strengths."

4. Public sector commissioners should consider the impact on charities of the way contracts are tendered and awarded. There should be allocated responsibility within government for reviewing this. Prime contractors should have a similar obligation in respect of their sub-contractors.

Involvement in public service contracts is another source of financing and a route to public benefit delivery for charities. This is not advocating anything other than a level playing field and bracing commerciality which is a disciplining factor for the sector. There is, however, a difference in the way such contracts' terms affect social capital rich, financial capital poor organisations from how they affect financial capital rich, social capital poor organisations. Public sector commissioners and prime contractors need to consider the implications for an undercapitalised sector and consider what outcomes they want to be incentivised in the round.

If a policy aim is a more powerful civil society sector more widely involved in service delivery then Government could consider asking the National Audit Office (or establishing a similar mechanism) to review the effect of public sector commissioning terms of trade on charities' involvement and whether the effect has grown or contracted the sector.³² In working efficiently along supply chains (and in the sector more generally), there is a need for clear, accessible information which can be shared, collated and analysed to report effectively (see the Impact, Transparency and Accountability Agenda). Prime contractors and commissioners need to ensure that such reporting is practical and there are systems to facilitate this.

Many prime contractors work effectively with the sector and recognising its distinctive benefits. Good practice should be identified and built on. We welcome constructive partnerships between prime contractors and charities and advocate that many of the recommendations in this report should be considered as part of a mutually beneficial prime/sub relationship.

³² Building on, for example, the 2005 NAO report *Working with the Third Sector*, http://www.nao.org.uk/publications/0506/working_with_the_third_sector.aspx

Merlin Standard – Co-regulation in Supply Chains³³

The Merlin Standard is a means by which the Department of Work and Pensions (DWP) can provide stewardship of the welfare to work marketplace via a co-regulatory approach with providers. The Merlin Standard has been designed to recognise and promote sustainable excellence and positive partnership working within supply chains and provide guidance to those seeking to achieve it.

It is built upon four fundamental and integrated principles: Supply Chain Design, Commitment, Conduct and Review. These Principles have been designed to examine key areas of the relationship between and the quality of a Prime Contractor and its Supply Chain Partners. Criteria underpinning the principles also seek to review the role of Commissioning, including the procurement process, and how supply chain behaviour is affected by the behaviour of the Commissioner.

The Principles are established to validate positive behaviour of Primes and supply chain partners in line with the Code of Conduct, a key facet of the Commissioning Strategy in creating healthy and high performing supply chains.

Working Links

Working Links is a public, private, voluntary limited company incorporated with the primary aim of competing with the private sector to deliver employment contracts. Its cross sector structure derives from the four shareholders: Mission Australia (an Australian welfare to work charity holding one third of the share capital), the Secretary of State for Work and Pensions (also holding one third), and two private sector shareholders, Manpower plc and CapGemini UK plc, holding a sixth of the share capital each.

This unique structure means Working Links brings together private sector drive, public sector ethos and voluntary sector ethics. This approach has proven very effective – Working Links now employs 2,000 staff, turns over £85m pa³⁴ and in 2009 helped 16,700 disadvantaged or long-term unemployed people into employment, an increase of 1,190 (8%) on the previous year.³⁵ This shareholder structure enabled the private sector shareholders to underwrite the necessary working capital necessary to deliver these contracts and allow an innovative and effective approach to welfare to work provision. This facilitated an inherently less risk averse culture within the organisation and, as a result, it is able to push the boundaries in maximising its social impact through experimenting and taking a more proactive approach to calculated risks.

The company is a for-profit organisation and not a registered charity, distributing 50% of retained net profit to shareholders, 20% to the Links Foundation, and retains 30% in the Company, subject to certain criteria.³⁶ Maximising shareholder value helps retain the private sector shareholders (and therefore the certainty over working capital), as well as creating value to be distributed through the Foundation. However, given the contracts are outcomes focused, the organisation only wins financially when it has delivered a social return, so social impact is embedded throughout the organisation's work.

33 Adapted from *Merlin – Supply Chain Excellence* (http://www.dwp.gov.uk/docs/sub_contracting_merlin_standard.pdf)

34 http://www.workinglinks.co.uk/about_us.aspx

35 <http://www.shareholderexecutive.gov.uk/performance/workinglinks.asp>

36 *ibid.*

5. Charity Commission guidance should encourage boards and management teams of charities to review their financing strategy in order to ensure the financial sustainability of their public impact.

Commission guidance should encourage a regular review of financing strategies to ensure a timely and appropriate approach to organisational risk management and sustainability (see earlier recommendations). Too frequently these can be documents which are created then shelved as one-off products. They should, however, be living documents and continually updated for new scenarios and challenges. It is imperative that the options and strategies available for organisations reflect their current needs; Charity Commission guidance should encourage this process and review.

As CDFG and PKF suggest "Despite the need to get risk management right, charities must be careful not to become over cautious. It would be disastrous for the sector to stifle innovation and no longer push the boundaries in delivering for beneficiaries. As ever, the balanced approach is to take calculated risks, while understanding them fully."³⁷

6. The Charity Commission should encourage charities to review their constitutional documents to ensure they are able to adopt financing options they may wish to exercise in the future.

Charities should ensure there are no restrictions in adopting potential sources of finance to increase their public impact. This is a matter of making sure options are open for the future at a time when organisations do not need them rather than waiting until they do and then incurring legal and process costs and delays. Guidance should be issued by the Commission on the types of financing options available to charities and should also issue an updated pro forma (adopting the changes suggested in this report) enabling organisations to adopt financing options they may wish to exercise in the future.

7. 'Co-investment'³⁸ should be encouraged by Charity Commission guidance

Commission guidance to charities and to charitable foundations should encourage this approach. Charities should also encourage this through their own fundraising activities. Co-investment can be between two traditional charitable funders, between a charitable and private sector funder, or between a public sector grant-maker and private sector or philanthropic donors. Government should positively welcome the opportunity to leverage up the return on its grants by being open to other funders or donors to work alongside them, increasing the return on public money.

Trading: Recommendations for the Sector

8. The concept of 'primary purpose trading' should be better understood to reflect that social enterprise trading and charitable operations now overlap significantly in delivering public benefit.

For a charity, trading activity that is "primary purpose" can be done through the charity's own operations. However, other trading activity (often, for example, including Christmas

³⁷ PKF and CDFG Risk survey 2009 - Managing Risk: Keeping in Control, accessed at <http://www.cfdg.org.uk/cfdg/surveys.asp>

³⁸ A policy of two or more funders funding together or using funding from one source to bring in matching or supplementary funds from another source

card sales) deemed not to be directly in pursuit of the charity's core mission is required to be conducted through a separately incorporated legal entity with a separate board to preserve the charitable assets from the trading risks. As a general principle this is sensible and such a distinction should be maintained.

However, more and more trading activities are being taken part in to further directly charities' core mission. Such social enterprise activity has shifted from being a financing or fundraising mechanism only (therefore not primary purpose) to being part of the delivery mechanism by which the public benefit is itself achieved – i.e. primary purpose. Those in, and advising, the sector must ensure they fully understand the potential benefits (and the most appropriate structures) available to the sector from trading. Involvement of beneficiaries in trading work to realise the public benefits of giving them "hard" and "soft" skills, socialising them, giving them a fresh basis for self-confidence, and improving their mental and physical health is but one classic example. Whilst trading by beneficiaries falls outside of primary purpose trading, it is still exempt from corporation tax and can be done by the charity without needing a trading subsidiary.

This is not only about public service delivery, but also about shaping charitable work to be most effective and facing up to the need for charities' financial platforms to be as diversified and robust as possible and no longer necessarily relying wholly on traditional sources of charitable income. A trend for grants to become more outcome-linked and therefore more "quasi-contractual" in nature also reinforces the point.

The problem with treating trading activity as non-primary purpose is that it introduces barriers between what are often just two different types of charitable activity, targeting the same beneficiaries and the same public impact. Charities want management and accountability for charitable work with the same sorts of beneficiary and achieving the same sort of outcome to be managed as one whole.

Trading activity can be reassigned to be primary purpose, but this can be time consuming and costly and slow down processes in often fast moving contexts. Also, once a certain legal and accounting and managerial infrastructure has been set up, it is additional work to remove it even for cost and clarity of management benefits.

Charities will be able to determine the most sensible way from an accountability and risk management perspective for their activities to be divided up into different units. The main point should be to ensure an overall adequate system for risk management. Within this there is an important need for organisations to be able to cope with the accounting requirements of trading. This is particularly true of allocating overheads³⁹ to ensure that services are appropriately costed. Organisations should take care in reviewing the assumptions placed into a costing model to ensure that a new service, project or contract is not actually losing money (unless strategically intended).

The onus on charities should be to disclose publicly and explain the level of trading activity and risks contained within it (as well as how that risk is managed). The regulatory default option should be to be much more open to trading activity being categorised as primary purpose.

³⁹ Full Cost Recovery, developed by ACEVO and NAVCA, has been instrumental in raising this issue. There is still, however, further progress needed in educating the sector in appropriate costing

9. Where applicable, charity boards and management teams should ensure their governance arrangements have oversight of the whole group and all the activities encompassed by the charity's brand.

Just because a project or piece of financial risk is in a separately constituted trading entity (which charity trustees may feel less involvement with), it should not be treated as somehow separate or something the "charity" is protected from, but should be subject to just as much scrutiny. Good charities of course know this and recognise the associated risks when making strategic decisions, reviewing risk or setting materiality limits. But this is an example of where well-intentioned regulation can have unintended consequences.

10. Charities should review their constitutional documents to ensure they have the powers for trading activity in the future should it become appropriate.

Following recommendation 6, reviewing constitutional documents prior to an organisation's need to trade is a much more efficient and strategic means of operating.

II. The Professionalisation Agenda

Overarching principle: The Charity Commission should see leading and shaping the sector's public impact culture as a cost efficient source of high impact regulation. This should be achieved through support for professionalism, proactive guidance and a vision for the sector.

This is about professionalism with a small "p" – not as a value pitched against the civil society, voluntaristic and solidaristic established values of our sector but as a vital means for realising our values and achieving as much public benefit as we can. If we believe in the distinctive impact and social outcomes that our organisations have, we should recognise a duty for the sector as a whole to give the benefit of our impact as widely as we can.

This agenda is therefore about maximising public benefit by removing barriers to organisational efficacy. This follows from our public benefit and effective pluralism principles and addresses the internalised regulatory culture of the sector.

The detailed recommendations that follow deal with governance, risk education and strategic training of boards and management teams, co-regulation (regulators working with regulatees to regulate) and avoiding regulatory overlap. All of these are part of the wider regulatory framework for charities and of achieving effective, high impact, proportionate regulation through indirect and 'cultural' means.

Recommendations for Regulators, Funders & Government

1. Regulators, Government and the sector should agree a system to identify and eliminate duplicative regulation.

As our sector's operations cover a wide range of activities, some of which are subject to specialised functional regulation (the area of care is an obvious example), substantial regulatory overlap has developed creating large burdens for organisations in reporting duplicated facts to many regulators. This overlap of regulators has been recognised across Government (e.g. in the design of their Forward Regulation Programme) as well as from

across civil society (see, for example, Margaret Bolton's 2004 report for the National Council for Voluntary Organisations⁴⁰).

One example of a lack of regulatory co-ordination lies in the reporting of serious incidents. Different regulators are naturally concerned with different issues. Whilst, for example, the Charity Commission would look at fraud as being a serious incident, the Care Quality Commission (CQC) sees patient harm as a serious incident and Ofsted views injury or abuse as being serious incidents. No-one would suggest that these are not examples of serious incidents, but the problem lies in the Charity Commission increasing the breadth of what they consider to be a serious incident. So that now what may have been previously reported just to the professionally applicable regulator; is also required to be reported to the Charity Commission in a different form in a different report using a different process. Duplicated reporting also exists for auditors (or other independent examiners) that find financial irregularities in a charity – they will need to report both to the Serious Organised Crime Agency (SOCA) under Money Laundering Regulations as well as the appropriate charity regulator under whistleblowing duties.

This is time consuming and costly, and it is not clear what practical regulatory advantage is obtained from these additional reports when the underlying information has already been submitted to other regulators.

A more joined up approach to regulation would suggest that for a specific aspect of an organisation's regulated activities, like serious incident reporting, the most appropriate/best placed regulator should be the primary regulatory contact point for organisations for that issue. This could be decided through a regulatory assessment framework, further memoranda of understanding or through bilateral meetings between regulators with sector and governmental involvement on a sub-sector by sub-sector basis. All charities involved with, say care of the elderly, would end up knowing what they have to report to the care regulator and what they have to report to the Charity Commission without duplicative reporting. There is already some excellent work being done around public sector data sharing;⁴¹ it is necessary to build on this to ensure data can be easily accessed and shared across regulators.

By adopting such a stance, the principal regulator identified can share commonly required information instead of organisations submitting multiple filings or undergoing multiple audits. This would allow organisations to concentrate on submitting the details of most individual interest to the various regulators. This is much more efficient for organisations as well as their regulators. The real savings in cost and time can instead be reinvested in organisation's public benefit missions.

A more radical suggestion could include the Charity Commission following a super-complainant approach similar to that of the Office of Fair Trading, whereby complaints from certain organisations on regulatory overlap are prioritised and fast-tracked through a resolution process.⁴² A super-complainant responsibility for the charitable sector could be successful discharged through, for example, one of the national umbrella bodies, which could call attention to a significant example of regulatory overlap and which would provide a level of constructive mediation and protection against unnecessary allegations.

40 Bolton, M. (2004) *The Impact of Regulation on Voluntary Organisations*. Accessible at http://www.ncvo-vol.org.uk/sites/default/files/Margaret_Bolton_The_Impact_of_Regulation.pdf

41 See, for example, Improvement and Developing Agency (2010) *Tackling Worklessness – Good Practice in Data Sharing* (<http://www.idea.gov.uk/idk/aio/19221282>)

42 Super complainants (for the OFT purpose) are "informed bodies who are in a strong position to represent the interests of groups of consumers and able to provide solid analysis and evidence in support of any super complaint they may make." (http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/of514.pdf)

The point is not any kind of claim that charity or other civil society organisation should have any sort of regulatory privilege or exemption in the particular functional sectors in which they operate. It is of course essential that regulatory standards should be consistent and adequate across each functional sector irrespective of the legal form of the organisations providing services within it. The point is to avoid regulatory overlap and, in particular, to avoid situations where an issue which is properly the domain of the functional regulator stimulates more regulatory reporting to another regulator just because of the legal form of being a charity.

Charitable Incorporated Organisations (CIOs)

The CIO was conceptualised in a 2002 paper from the Cabinet Office Strategy Unit⁴³ and its broad legislative framework was set out in the Charities Act 2006. The concept behind the CIO was to create a legal structure which removed the dual regulation of charitable companies by both the Charity Commission and Companies House – CIOs would only have to register with and submit filings to the Commission. The reporting requirements are also less onerous for small organisations, which reduces costs to an organisation even further.

The CIO was initially expected to be introduced from summer 2008; however, delays with finalising the secondary legislation, as well as operational concerns raised by the Commission meant that, as at May 2010, the CIO was not expected to be operational until late 2010 or early 2011. Whilst it is critical that the CIO is workable, so ensuring it is not introduced prematurely is important, when introduced the CIO will be a key method of reducing dual regulation for many charitable organisations.

Charity Commission and Housing Corporation approach

Charitable Registered Social Landlords (prior to the establishment of the Tenant Services Authority) were regulated by both the Charity Commission as well as the Housing Corporation.

To streamline regulation for charitable Registered Social Landlords (RSLs), the two regulators worked together to produce practical guidance⁴⁴ as well as having a specific Memorandum of Understanding⁴⁵ between them (something the Charity Commission has now extended to other regulators – see Appendix III) to direct how they would form policy, work together and share information. This MoU was favourably received in the sector, for both the clarity it brought as well as the reduced levels of duplicative reporting without impacting on the regulators' statutory duties.

2. **The regulatory default option on governance should be that charities are best placed to determine the most appropriate board structure to meet their mission, providing it is publicly disclosed.**

Charities should be able to decide the most appropriate governance structure to deliver their public impact most effectively. This concept needs to be analysed as the separate and not necessarily related issues of:

- a. Providing compensation where the prospective trustee is unable to afford the indirect expense and time associated with acting as a trustee.

43 Strategy Unit, Cabinet Office (September 2002) Private Action, Public Benefit: Charitable Incorporated Organisation

44 http://www.charity-commission.gov.uk/Charity_requirements_guidance/Specialist_guidance/Housing/hcguide.aspx

45 http://www.housingcorp.gov.uk/upload/pdf/Charity_Commission_MoU.pdf

- b. Providing compensation to attract greater diversity of perspectives around the board table including from beneficiaries if judged appropriate
- c. Including chief executives and potentially other senior managers on the board to take advantage of their greater knowledge of the organisation
- d. Providing compensation to all or some trustee board members (the chair or the treasurer perhaps) where some of their service to the organisation goes beyond a purely "non-executive" role and becomes more time consuming to involve more public representation of the organisation for example or more detailed involvement in financial management
- e. Providing compensation to trustee board members as a point of principle for acting as trustees in order publicly to value commitment and professional service. This may well require a form of capping or linking to an external scale (e.g. ACEVO pay survey/Civil Service scale)

Wanting to pursue one of these options does not commit an organisation to supporting or wanting to pursue all of them. They are logically separate and too often bundled together. Not all organisations will want to exercise any of these options. But under effective pluralism, the point is that those who, after considered reflection, believe it is in their organisation's best interests for its public benefit should not be prevented from doing so, with adequate public disclosure of the facts and justifications. Reasonable people do reasonably disagree. We have a richly plural sector which is justly celebrated for its diversity and the logic of that pluralism should be followed.

St Andrew's Healthcare – an example of a completely unitary board

St Andrew's is the UK's largest not-for-profit mental health care charity. They offer men, women, adolescents and older people specialist services across mental health care, learning disability, acquired brain injury and progressive and neurodegenerative conditions.

In 2004, St Andrew's realised a requirement for a more efficient approach to the organisation's governance in order to compete successfully for business with private organisations. They decided that the best way to promote organisational effectiveness was to have a unitary (business) board bringing together the non-executives and executive management. This was part of a wider organisational change as St Andrew's was also seeking to restructure as a registered charity. They engaged with the Charity Commission in articulating these changes and carefully worked through the practical complexities of their expression. A key aspect in succeeding with the unitary board was St Andrew's commitment to the Combined Code.

The Unitary Board now comprises five unpaid trustees (including the non-executive Chairman and Vice-Chairman) sitting alongside the five senior executives (CEO/Medical Director; Director of Nursing, Director of Finance, Director of Development and the Head of Legal/General Counsel).

St Andrew's has found this structure to be very effective in driving the ethos of a business culture – faster decisions, clearer strategic thinking and an increased success in the market place - throughout the organisation whilst retaining its base mission and values.

As Prof Philip Sugarman, CEO and Medical Director of St Andrew's, stated "In short, St Andrew's has been very successful since the Unitary Board came into being, thriving despite commercial competitors, developing innovative services no-one else offers, and

nearly doubling the number of service users we help. The Board upholds the principle of voluntarism, brings in great business expertise, and allows quick and effective decisions closely involving the Charity's staff. The Charity's impact on public benefit has never been stronger."

Anchor Trust – An example of an organisation paying all of their trustees⁴⁶

Anchor Trust describes itself as England's largest not-for-profit provider of housing, care and lifestyle options, with the aim of improving the lives of older people. It has an annual turnover of £247.4 million and is a Registered Social Landlord. In 2003 the Charity Commission authorised the remuneration of all of Anchor's trustees. The level of remuneration is in line with the levels determined by the Housing Corporation.

Jane Ashcroft, Managing Director for Care Services, explained that Anchor Trust had taken the decision to pay its trustees to attract experienced non-executive directors and to recognise the scale of the responsibility of being trustee of such a large and complex organisation. They have received excellent responses in recruitment campaigns and the trustee board scored highly in an independent review of their effectiveness, carried out by ICSA. In addition, they have found that paying trustees has led to improved attendance at meetings and has contributed significantly to organisational success and development.

MHA Care Group – an example of a completely voluntary board⁴⁷

MHA Care Group provides care homes, housing and support services for older people throughout Britain, delivering a range of services to over 12,000 individuals.

Roger Davies, Chief Executive, outlined what MHA sees as the benefits of having a voluntary board. He argued that high calibre individuals will be willing to serve unpaid if they believe in the charity.

Unpaid trusteeship is an inspiration to volunteers throughout the organisation. MHA also feels that paying trustees may be a disincentive to giving for some donors and that having a voluntary board ensures a clear perception of an organisation run by individuals who are committed to the charity's mission, with no other incentive to doing what they do.

Roger also stressed the importance of board members not being dependent on executives for their remuneration, thereby ensuring independence in decision-making and holding executives to account.

3. Work should be undertaken to understand and address the blocks stopping employers (from all sectors) from recognising the benefits of and encouraging their employees to serve on charitable boards.

The Commission and Government should take steps to encourage this, not least for public sector employees. The current position is woefully short of ideal. In our evidence taking, one (representative) example was the vice-chair of a national charity who was a public sector employee and was required to fulfil her board duties using her annual leave entitlement: fine personal commitment but wrong as a societal principle and lack of commitment to our sector.

⁴⁶ http://www.charitycommission.gov.uk/About_us/About_the_Commission/trindex.aspx#3

⁴⁷ *ibid.*

Employers should recognise the benefits to the personal and professional development of their staff of serving on the board of a charity and should take account of it in employee personal development plans. With Commission or Government encouragement (for example, tax incentives), there could be a sector scheme whereby charities commit to certain standards of board development and conduct in return for employers' endorsement of their staff's commitment.

From a regulator's perspective, this would greatly add to the pool of available board members, strengthening governance, accountability and regulatory outcomes.

Arts and Business⁴⁸

Arts and Business is an organisation bringing together private businesses and the arts sector. They run a service called Board Bank which connects skilled professionals with cultural organisations. Since 1988, they have placed more than 5,000 business people as non-executive board members and advisors with not-for-profit arts organisations.

Arts and Business train executives in good governance, help them understand their roles and responsibilities, and facilitate introductions with the board as a possible trustee or non-executive director. Their business executives bring a range of professional and commercial expertise, enthusiasm, new networks, perspectives and ideas to boards.

4. There needs to be greater use of professional standards and greater recognition of the benefits of co-regulation within the sector. A greater use of peer review mechanisms, particularly for reporting impact, should also be explored.

Reactive or post-event regulation is less effective than strategic or preventative regulation. Top-down rule based regulation is often less effective than regulation by professional culture and sector professional standards when supported by informed case review interventions to ensure substantive compliance.

Ways in which the sector can become co-regulated with greater high impact use of professional standards should be examined instead. This will not only increase the efficiency of the Charity Commission, enabling it to concentrate on high-impact, low frequency regulation, but will also help address the pluralistic nature of the sector.⁴⁹ The sector has already prompted the Government to look at this in more depth (see, for example, Bolton (2004)) but this has yet to have much ground level impact.

Ways in which the sector could be effectively co-regulated would include through a sector-based board to peer-review civil society organisations, a more formal training/development programme or professional standards for organisations. This has already taken place in, for example, fundraising and could easily be spread throughout the sector. This would also present an opportunity to regulate how civil society organisations are used in delivery chains through, for example, extending a code of conduct model similar to DWP's Merlin Standard.

Impact reporting would be a high profile and interesting case for the use of peer review. It is an example of a developing area of high informational and regulatory impact where there is no one "right answer" and an inherent pluralism of approaches making a

⁴⁸ Adapted from <http://www.artsandbusiness.org.uk/Central/arts-services/Board%20Services.aspx>

⁴⁹ See, for example, Charity Finance Directors' Group position paper *Regulation and Charities*

prescriptive approach currently unworkable. Professional peer review (maybe by a mixture of peers within the sector and academic style peer review by economists or finance specialists from without the sector) would provide the authoritative assurance needed on such important information without prescriptively stifling the necessary experimentation.

St Giles Trust

St Giles Trust is a charity which aims to break cycles of offending, crime and disadvantage. In early 2010, an economic evaluation,⁵⁰ initiated by Pro Bono Economics and carried out by economics consultancy Frontier Economics into St Giles Trust's Through the Gates programme, was launched. The report showed Through the Gates was very effective – cutting re-offending by 40% and saving the public purse £10 for every £1 invested. Not only was this a pioneering report in the use of the official Government OAsys data, but also the level of peer review the report went through was unprecedented. Senior economists from across the private and public sector critically reviewed the original assumptions and figures produced by Frontier Economics to generate an unquestionable final figure.

Institute of Fundraising and the Fundraising Standards Board⁵¹

The Fundraising Standards Board (launched in 2007) is an independent body that has been established to introduce and operate the self-regulation of fundraising in the UK.

The Fundraising Standards Board encourages charities and other fundraising organisations to become members of the scheme and ensures that each member commits to the highest fundraising standards, and that they have a robust complaints procedure in place.

Members of the Fundraising Standards Board Scheme must:

- Follow the Codes of Fundraising Practice
- Display the FRSB tick
- Tell people about the fundraising promise
- Be ready to handle complaints

The 12 Fundraising Standards Board's Board members are responsible for making final adjudications on public complaints about fundraising. In order to represent a balance of interests, the Board members include representatives from the voluntary, consumer protection and charity law sectors, plus five lay board members.

NAAPS Quality Mark for Micro-Providers

NAAPS is the UK voice of small community based health and social care service providers. Their members' experience of regulation has been either over regulation (i.e. micro providers required to meet the same regulatory and compliance criteria as large providers) or lack of regulation. This has created serious issues for both providers, some of whom are experiencing a disproportionate level of regulation, and Local Authorities, which require a level of assurance over providers from which they commission services.

50 http://www.stgilestrust.org.uk/News/446435/economic_study_shows_support_for_prison_leavers_cuts_crime.html

51 <http://www.instituteoffundraising.org.uk/bestpractice/selfregulationoffundraising/aboutthefundraisingstandardsboard>

NAAPS received funding from the Department of Health for a pilot to support micro-providers and to develop and test a suitable quality mark for micro providers. NAAPS brought together a variety of stakeholders including regulators, commissioners, users and providers to develop the quality mark. The Mark is currently being piloted in Oldham and is much more akin to the assured-tradesman approach taken by many trading standards departments.

In order to become accredited, there are three stages to pass through.

1. The Preparation Stage

The organisation decides to attempt the standard. A local support agency then helps providers gather the evidence necessary to pass Stage 2.

2. The Gateway Stage

This is a paper-trail stage to ensure that providers are fit to provide services. The evidence provided is then assessed by a local panel chaired by a senior representative from the Local Authority. If the organisation is assessed to have passed through the Gateway stage then it is awarded a Silver mark by the panel.

3. Annual Review

Organisations which have achieved the Silver mark are then annually reviewed using a variety of methods including mystery shopping, reports from users on their experience and further scrutiny of data submitted by the provider. The final decision lies with the same panel as at stage 2 as to whether the provider should be awarded a gold mark. This review takes place annually.

The quality mark is currently in very early stages of pilot, but is already a requirement in the pilot area for micro providers wishing to join the Approved Provider list. NAAPS are planning a more extensive regional pilot (probably in the West Midlands and are in discussions with CQC and Supporting People about the mark being used as evidence that regulatory and accreditation standards are being met. NAAPS is working to obtain UK accreditation of the quality mark.

Advertising Standards Agency Approach⁵²

The UK advertising regulatory system is self-funded by advertisers and comprises a mixture of self-regulation for non-broadcast advertising and co-regulation for broadcast advertising. The vast majority of TV and radio ads are pre-cleared before they are broadcast through two approved centres.

Under their licences broadcasters must take reasonable steps to ensure that the ads they broadcast are compliant with the TV and Radio Advertising Codes. Whilst non-broadcast media is not pre-cleared, there is a large database of resources available for reference, as well as the ASA proactively monitoring ads to keep standards high and maintain a level playing field for business. Furthermore, consumers also have the right to complain about ads they have seen, which they believe to be misleading, harmful or offensive.

Furthermore, the ASA works strategically with other regulators. It has a co-regulatory partnership with Ofcom for TV and radio advertising and a close relationship with the Office of Fair Trading (OFT), which serves as the legal backstop power for misleading non-broadcast ads.

⁵² Based on [http://www.asa.org.uk/Regulation Explained.aspx](http://www.asa.org.uk/Regulation%20Explained.aspx)

Tenant Services Authority (TSA) Approach to Co-Regulation

Following the Cave Review of social housing regulation, which was the basis for the formation of the TSA (replacing the Housing Corporation), regulation in social housing has become less prescriptive as part of a drive to a lighter touch, low frequency, high impact agenda.

The TSA definition of co-regulation is robust self-regulation by the boards and councillors who govern the delivery of housing services (incorporating effective tenant involvement) and is subject to a 'backbone' of regulation by the TSA.

There are ten principles that define the TSA's approach to co-regulation⁵³:

1. Their national standards are based on clear criteria
2. They are clear; they focus on outcomes and they avoid prescribing detailed processes
3. Providers should agree local service standards with their tenants
4. Providers should respond to the needs of their tenants and demonstrate how they have taken into account the needs of the diverse range of tenants
5. Promote transparency by enabling tenants, landlords and councils to assess performance of providers in their area
6. Good governance is a universal principle and is essential to the quality of service delivery, financial robustness and value for money
7. Independent validation, audit and benchmarking of performance to encourage providers to improve continually and free the best from unnecessary red tape
8. The focus of our resources in 2010-11 will be on identifying and addressing the worst performing providers
9. Where problems are identified, the provider will usually be offered an opportunity for speedy self-improvement
10. Registration criteria should encourage new landlords into the social housing sector

5. A significant new area of regulatory duplication for charities proposed by recent HMRC rule changes should be urgently re-thought and avoided.⁵⁴

The Finance Act 2010 brought in a new range of tax reliefs for donations to charitable organisations based outside the UK provided certain conditions are met. In order to qualify for the relief, non UK organisations must meet four new tests as HMRC wishes to be satisfied that the body is run by appropriate persons, and is not a vehicle for fraud.

These tests are:

- a charitable purposes test: the organisation must be established for charitable purposes (as defined by the Charities Act 2006);
- a jurisdiction test: the organisation must be subject to the jurisdiction of a UK court, or a court in the EEA;
- a registration test: the organisation must comply with any local obligation to be registered with an appropriate regulator; and

⁵³ <http://www.tenantservicesauthority.org/server/show/nav.14727>

⁵⁴ Adapted from the Bates Wells & Braithwaite briefing note.

- a management test: the organisation must be run by “managers” who are “fit and proper persons”.

However, the new tests also apply to UK charities - including those registered with the Charity Commissions or OSCR. The new management test may prove very problematic to meet. Furthermore, hitherto, HMRC has generally accepted that an organisation which qualifies as a charity under UK law will be a charity for tax purposes, UK charities wishing to qualify for UK tax relief must now fill in a completely new form.

Some particular concerns are:

- The definition of “managers” in the legislation is the same as the definition of “charity trustees” in the 1993 Charities Act. However, HMRC’s guidance suggests a wider definition.
- There is no definition of “fit and proper” in the legislation. The HMRC guidance also indicates that it is seeking to identify those who “present a heightened risk of prejudice to the charity’s tax position” or who present “a heightened risk of involvement in other fiscal or financial impropriety”. The guidance expressly notes that “it does not necessarily follow that individuals who are considered by a charity regulator to be suitable to act as trustees of charities will be considered to be fit and proper persons for the purposes of the management condition”.
- The new definition introduces an unwelcome degree of uncertainty as there is no clearance procedure for trustees.
- The new form imposes yet another bureaucratic burden on charities. Much of the information it demands (including information on public benefit) mirrors information which will already have been provided to the Charity Commission on an application for registration.

This is a major new source of regulatory overlap entailing significant new investment of time and resources by charities that would otherwise go to organisations’ public benefit missions. For the vast majority of charities, this new action will be a sledgehammer taken to a non-existent nut (a minority problem of tax evasion, money-laundering and other illegitimate activities). Applying these new rules to the charity sector as a whole will be disproportionate compared with case by case investigation of organisations prima facie believed to be potentially involved in illegitimate activities.

We recommend that what amounts to an under-publicised duplicative re-regulation of the charity sector is urgently re-thought.

Recommendations for the Sector

6. **Charities should ensure their constitutional documents have the power to exercise different governance options in the future should they become appropriate.**

This follows from recommendation 2 and recommendations 6 & 10 in the Enterprise Agenda. The Charity Commission should update the constitutional pro-forma to reflect this recommendation and take steps to expedite organisations' reviews of their governing documents.

7. **There should be greater sector investment in board recruitment and training. The idea that serving on a charity board is personally and professionally fulfilling should also be better promoted.**

The regulatory framework should encourage and facilitate this as a drive towards high impact for regulatory outcomes. A significant element of charitable regulation should take place within organisations themselves to encourage a more co-regulatory approach to regulation. This, however, can only happen if boards have the right skills to fulfil their part of the obligation. The sector must ensure that it is able to attract people with the requisite skills and that organisations are able to give suitable training to those who need it. There has been significant improvement in these areas over recent years and there are now important initiatives taking place within the sector. However, it is critical that they are mainstreamed and scaled up to increase their impact and obtain greater cross-sector buy in.

8. **Charities should review, update and disclose the impact of their practices and plans for investing in the quality of their governance structure.**

Governance and boards do matter. They are not the answer to everything, but they are something. Every sector finds governance challenging. However, without effective governance, charities lack the checks and balances, the internal accountability, the need to report and justify, and the constructive challenge and constructive tension within a joint context of commitment to the organisation's mission and objectives that strengthen strategic decisions and performance.

Too often in the sector, governance is left stranded and stretched between two unreconciled positions: (i) a formal heaping of all ultimate responsibility onto trustee boards without also emphasising the need for training and development and investment in the relationship with the management team; and (ii) a sector practical emphasis on "protecting" chief executives from their boards.

Above all, it should be recognised that effective governance is located in a quality relationship between board and management and not just in either board or management teams. Governance should be a concept which evolves, adapts and continually seeks to improve. There is a necessity therefore to ensure that governance structures are continually invested in and evaluated by organisations to ensure a continued improvement in their governance performance and efficacy.

Charities should therefore invest in: (a) strategic and financial training for boards and management teams to help them think strategically and not just operationally (avoiding the "operational trap" of a sector used to living on short rations from one moment to the next); and (b) opportunities for boards and management teams to develop their relationship and find an effective joint working style as a matter of duty.

The regulatory framework should encourage these issues as a matter of high impact proportionate benefit to regulatory outcomes.

WaterAid Board Meeting Strategy

WaterAid is an international non governmental organisation that aims to transform lives by improving access to safe water, hygiene and sanitation in the world's poorest communities.

WaterAid's board has ten voluntary trustees based across the globe who meet four times per year. Each meeting is held over two days, starting with an informal dinner on the first evening between the trustees and the executive directors. This allows the trustees to discuss topical operational issues, discuss any queries from the board papers and get up to speed with WaterAid. The next morning the Board meet a cross section of staff in the office to discuss openly a relevant high-level issue. There is then time for staff to ask questions or query any points made with the trustees. The actual board meeting then takes place that afternoon.

Barbara Frost, Chief Executive of WaterAid, says "We find this process particularly helpful as, by the time trustees are at the board meeting, they are fully in WaterAid mode. Having such an intensive two days means there is pressure for the board papers to be excellent which strengthens internal accountability and transparency. Furthermore, engaging the executive and staff breaks down silos and engages people across the organisation in WaterAid's governance."

III. The Impact, Transparency and Accountability Agenda

Overarching principle: To increase accountability we recommend that the publication and regulatory filing of sector information should be radically reformatted, streamlined and made more transparent. This will allow greater co-regulation and a more practical public analysis of charity effectiveness.

Underpinning the previous two agendas is a need for a transparent and accountable sector which is able to demonstrate the public benefit it delivers. Accountability depends on clear information published by charities so that their impact and outcomes (against an appropriate counterfactual benchmark) can be assessed over an appropriate timescale with good performers recognised and backed again. We believe that such transparency gives the best regulatory outcomes and in a more efficient, higher impact way for the regulator.

The ImpACT Coalition⁵⁵

The ImpACT Coalition brings together over 280 charities and trade bodies to promote a better public understanding of how charities work and the benefits they bring to society. The Coalition does this by improving the sector's Accountability, Clarity and Transparency (ImpACT). Its members commit to criteria on which the Coalition's progress and success can be judged as well as promoting six key themes through their work:

Theme 1: Charities are effective and do a great job

Theme 2: To raise (more) money, charities have to spend money

Theme 3: Charities use donations carefully and wisely

Theme 4: Charities are highly regulated and adhere to a range of strict standards

Theme 5: Charities work together

Theme 6: Charities need the public's donations because they really do make a difference

The Coalition is free to join and members can use its toolkit to measure their transparency and accountability, then make plans for improvement.

We believe that public information on an organisation's impact performance best allows all those concerned with its performance to exercise constructive pressure on the organisation and hold it to account – including funders (including charitable funders and public sector commissioners), beneficiaries, the media and ultimately the public as a whole. We believe that such stakeholders acting together to hold an organisation accountable for its performance creates the best form of regulation. The Commission should therefore be focused on ensuring that the circumstances exist for publication of transparent, relevant information and for this complex of informed accountability-holding to be leading principles in the sector.

We believe that for charities, stating plans and goals then reporting candidly on where and how actual performance has been better or worse than expected, is the most time and cost efficient form of regulation.

We believe the most relevant information that charities can publish is on their public benefit impact and how they achieve it. The information for which charities should be held to account is their impact performance compared with what they said they would achieve and

⁵⁵ Based on <http://www.impactcoalition.org.uk/>

compared with what others undertaking similar activities are achieving. Regulation and accountability should be beneficiary-centred for that is what our sector exists for.

We need to recognise that impact reporting is at an early stage. No-one has the single "right way" of doing it yet. We need experimentation and as a sector we need investment in research into better ways of doing impact reporting. These should be key regulatory objectives in the interests of effective high impact regulation. Getting the information context right for the sector should achieve savings in other regulatory activities.

This is an area where the Charity Commission is taking a proactive lead; this includes their trend towards focussing on outcomes. This is to be warmly welcomed and the Commission's initiatives recognised. Urgency should be attached to these initiatives and to ensuring in the sector continued experimentation and innovation. The regulator should work through others and encourage them to ensure that this is the case.

A public benefit information centred approach should enable: compensating regulatory savings in other areas; an improvement in the strategic capacity of charities themselves as they learn more about their peers and the sub-sectors they operate in; improvement in the Commission's own ability to target its case reviews and other regulatory interventions; and markedly enhanced accountability compared with the current position. When an organisation is accountable to multiple stakeholders for many different areas, the result is a low level of effective accountability (the big picture accountability is buried in detail). But when consistent reporting of a public benefit narrative consolidates accountability around a single, bigger picture story the result is real accountability.

Our detailed recommendations in this area are aimed at supporting this:

Recommendations for Regulators, Funders & Government

1. Duplication in regulatory returns should be abolished and the number of different returns should be reduced. The Commission should amalgamate the Annual Return with the Annual Report and abolish the Summary Information Return.

Currently for the Charity Commission alone, organisations need to complete and submit each year an Annual Report, Annual Financial Statements, an Annual Return and, if their income is greater than £1 million, a Summary Information Return. This is added to by reports for Companies House, HM Revenue and Customs (HMRC) and for other sector-specialist regulators, if applicable, such as Ofsted or the Care Quality Commission (CQC). Furthermore for UK-wide charities, the multiple reporting to different charity regulators is a major burden.

These reports often replicate information, resulting in a greater time cost for organisations than the marginal benefit gained from the additional collection. These reports may well need to be signed off and/or audited, which creates additional financial cost for organisations.

Best practice in streamlining reporting would be to collect the necessary information in a logical manner and presented in one annual document. The information reported can then be analysed by the regulator, commissioner or funder⁵⁶ for the most salient facts for them. The Charity Commission should review the content of regulatory filings to produce more standardised information about charity targets, plans and performance

⁵⁶ See, for example, Lofgren & Ringer (2010) *Well-informed: Charities and commissioners on results reporting: A National Performance Programme report for charities, funders and support providers*.

regarding their public impact. This information should be searchable by other stakeholders to reduce duplicated reporting and create a more transparent sector. Collecting and disclosing all information in such a manner would be more efficient for all parties concerned.⁵⁷

2. Regulators and funders should accept and encourage reporting standardisation and work with charities to achieve this.

Despite the obvious reality that different funders will naturally be interested in different details or facts, there needs to be an element of standardisation of reporting to increase efficiency within the sector. The sector is wasting too much time reporting significant amounts of the same information to different funders in slightly different formats. Funders, regulators and the sector should work together to minimise this burden and find a common, standardised methodology. Funders should look at accepting the audited (or otherwise externally examined) document outlined in the previous recommendation as best practice and avoid asking for the same information in a different form. Frontline organisations can then concentrate on producing specialist information for funders on their specific areas of interest. It is in the long term best interests of all funders to ensure that their funding produces a more effective charitable sector by the way they interact with the sector producing a considerably higher long run public benefit return on their funds than by concentrating only on short term projects and on the immediate direct impact of funding.

The Big Give

The Big Give is a website for proactive philanthropists to find and support charities. The Big Give currently features over 6,000 UK charities working all over the world.⁵⁸ In order to enhance comparability for funders, The Big Give recently introduced, in consultation with the charity sector, a standardised application form for charities to register on the website. Whilst the information is in standardised form, many of the questions asked were phrased in wide enough terms so as to be applicable to as many organisations as possible.

3. The Charity Commission and Government should procure investment to research impact reporting with the aim of creating a more transparent sector which requires less top down regulation.

This is the most effective single initiative that could, from both a regulatory and sector perspective, build a stronger, more resilient, more accountable civil society sector. There is currently a difference between the theory and praxis of impact reporting. Whilst impact reporting is critically important, strategically and for accountability, it is still at an early, developmental stage with some interesting experiments to build on. The sector needs to experiment how impact can best be reported. Procured research (either directly or, in the current climate, indirectly) is one method of aiding the sector in condensing the learning process; funders should also provide money to help frontline organisations evaluate the success of projects. A greater understanding and implementation of impact reporting will mean less top down regulation for the sector. There are a number of

⁵⁷ See New Philanthropy Capital's report *Turning the Tables*.

⁵⁸ <http://www.thebiggive.org.uk/about/>

innovative projects and methodologies currently being developed to prove and improve an organisation's quality and impact. These include:⁵⁹

- AA1000AS
- The Big Picture
- Co-operativesUK CESPIs
- DTA Fit for Purpose
- Eco-mapping
- EFQM Model
- EMAS
- GRI Guidelines
- Investors in People
- ISO 9001: 2008
- Local Multiplier 3
- PQASSO
- Prove It!
- Quality First
- SIMPLE
- Social Accounting
- S.E Balanced Scorecard
- SROI
- Star Social Firm
- Third Sector Performance Dashboard
- Volunteering Impact Assessment Toolkit

Commonweal Housing

Commonweal Housing is a charity which provides housing for projects focussing on solutions to different forms and experiences of inadequately or un-met social injustice. They work with specialist partners to define, provide and, importantly, commission independent evaluation of the services developed. Results from this research are then used to disseminate best practice and the lessons learnt.

An example of assessing impact - Outcome Assessment for Social Enterprise (OASES)⁶⁰

Since 2008, SEL has been working on the Outcome Assessment for Social Enterprise (OASES) project funded by Capacitybuilders. OASES aims to (a) develop a systematic decision making framework to enable social enterprises to make informed decisions when deciding which social impact tool is best for their organisation and (b) up skill social enterprises and provide them with the knowledge to articulate their outcomes, which is increasingly needed when bidding for public sector contracts.

The decision framework being developed in the OASES project will help organisations determine what tool/methodology to use when trying to capture the value of their organisation. The quadrants describe four elements of an organisation - strategic planning, performance measurement, external outcomes and external impact. Once the organisation determines the area/s they are keen to measure value in within those quadrants, they are able to review the tools/methodologies that are available for their selection.

4. **There should be more focus on sectoral information and comparisons being made possible to bring clarity to the sector and enable a more high-impact, low-frequency style of regulation to flourish.**

The most valuable analysis and accountability occurs when organisations operating in broadly the same fields (old aged care, say, or improving the environment) can have their

⁵⁹ <http://www.proveandimprove.org/new/tools/index.php>

⁶⁰ <http://www.sel.org.uk/impact-assessment.aspx>

performance compared. Absolute measures of performance give less meaningful information and generate less useful accountability questions than measures of performance that can be compared both relative to targets previously set and relative to the performance of comparable organisations.

There will always be an apples and pears debate about how comparable organisations even in the same focus of activity actually are but such arguments should be treated with a fair pinch of salt. The point of comparison is to generate interesting and meaningful questions. Such questions will adequately pick up and deal with what is different between comparable organisations as well as what is held in common and can be generalised. The most critical factors for this are that the information disclosed holds meaningful data for the organisations and that the assessment criteria/framework is appropriate for the situation. There will, of course, need to be a wide range of data available, both qualitative and quantitative, some of which will be directly comparable whilst others will require a degree of interpretation. This is important in order to capture the overall picture of the charity and offer more nuanced comparisons instead of black and white figures which may not tell the full story.

Charities have much to gain from such sectoral information and comparisons being publicly and easily accessible as it will better inform their own strategic thinking. Too many charities can have a tendency to operate in their own silo without account of comparable organisations. Charities should therefore welcome and facilitate a sectoral approach.

There should be regulatory interest in facilitating and encouraging investment in such a sectoral analytical approach. To some extent Guidestar represented, among other things, an initiative in this direction by allowing funders to compare organisations to make a more informed investment. Under its new owners, Guidestar might offer an investment opportunity to promote this sort of value added comparative information and analysis. Other investment opportunities may well be preferred.

Office of Fair Trading's (OFT) High Impact Approach⁶¹

The OFT is the UK's consumer and competition authority. Their mission is to make markets work well for consumers. They pursue this goal in a high-impact, low frequency manner by:

- encouraging businesses to comply with competition and consumer law and to improve their trading practices through self-regulation
- acting decisively to stop hardcore or flagrant offenders
- studying markets and recommending action where required
- empowering consumers with the knowledge and skills to make informed choices and get the best value from markets, and helping them resolve problems with suppliers through Consumer Direct.

61. <http://www.oft.gov.uk/about/>

Halton Community Action – Here to Help⁶²

In May 2010, a partnership of Halton and St Helens Primary Care Trust (PCT), Halton Voluntary Action and St Helens Council for Voluntary Services (CVS) produced Here to Help, an innovative and comprehensive brochure mapping local health and wellbeing civil society organisations. It was designed to help PCT commissioners understand the sector by making it more transparent and enable commissioners to compare local organisations more easily. The document gives basic background information for all organisations and categorises them against the PCT's strategic priorities.

- 5. Regulatory data should be uploaded, publicly available and accessible in searchable data form rather than as scanned documents or PDFs. Such public information should be freely available for all analysts.**

This is part of an ongoing broader theme in how public data is made available to the public and interested parties for analysis. The most interesting results (and enhanced accountability therefore) come when there is no monopoly over the way data is analysed. Performance data analysis on the sector should be an open system and not a closed one.

Recommendations for the Sector

- 6. Charities should look to consolidate and standardise the information they produce for funders and regulators to reduce the time spent on reporting.**

Charities spend too much time and money producing too many documents describing themselves and their performance – time and money that would be better spent on their core mission. Particularly as funders are expecting the sector to do more with less, it is important that this duplication is reduced to allow organisations to focus on delivering their public benefit. It is recognised, however, that the sector does need to become better at impact reporting first in order to create meaningful and accurate consolidated reports (see further recommendations in this section).

Umbrella organisations for the sector or for funders should take a lead on this. The Charity Commission should be interested in this because it should (a) give more meaning and weight to regulatory filings which could contain the core of such information and be the authoritative way of making it available and “kite-marking” its relevance; and (b) enhance the overall system of accountability and therefore regulatory effectiveness in the sector.

By way of analogy or illustration, a listed public limited company (PLC) engaged in raising funds produces one core document (its “prospectus” or “listing particulars”) containing what is judged to be the relevant information relating to the PLC and its fundraising. Some of this is audited information; all is carefully reviewed with very clear directors’ responsibilities. This is then made available to all potential funders (in a PLC’s case, investors). A PLC will not produce multiple slightly different versions of this core information document though it will of course speak to interested funders and answer their particular questions on the information or about the PLC generally reflecting funders’ particular criteria. This is a much more efficient process and gives a more holistic picture of an organisation.

62 <http://www.haltonvoluntaryaction.org.uk/news/107-here-to-help>

Turning the Tables (New Philanthropy Capital (NPC))⁶³

Turning the Tables argues that while it is essential for charities to demonstrate their effectiveness to funders through reporting, the current system often leads to duplication and unnecessary burdens that benefit neither the charity nor their funders.

The report highlights two significant problems with the current reporting system. Firstly, government agencies demand much more information than independent funders, often putting extra burdens onto charities. Second, all funders request reports in different formats, which results in the unnecessary duplication of information by charities.

As a solution, Turning the Tables recommends that charities should work more closely with funders in order to identify the key information they require and streamline the process. Charities should group similar funders together to coordinate their reporting requirements and reduce duplication. Simplifying the reporting process will improve the quality and efficiency of reports, put a greater focus on outcomes and evaluation and free up more money to improve services. NPC says that in order for government to achieve their aim of reducing the administrative burden faced by charities, steps must be taken to explore new ways of reporting.

7. Charities should refocus their reporting style towards a more candid appreciation of targets set, performance achieved and an acknowledgement of where and why performance has differed.

The Commission and other regulators, and also funders, should encourage this. Evidence suggests this improves accountability and the relationship with funders. It goes to the heart of public trust in the sector. Furthermore, the public has indicated that clarity of information on performance would be an important influence over whether to donate - 68% of donors to an NPC/You Gov poll said they would transfer their donations away from a charity if it were found to be performing badly.⁶⁴

This is quite a different style from a more regulatorily constrained style concerned with formal compliance. The former style is clearly more valuable and transparent than the latter in conveying organisational impact.

Little Blue Book (New Philanthropy Capital)⁶⁵

The Little Blue Book is NPC's concise and practical guide to analysing charities for charities and funders. The guide contains examples of how charities and funders benefit from analysis, and explains NPC's charity analysis framework, which looks at how charities can assess their effectiveness in six areas:

- activities;
- results;
- leadership;
- people and resources;
- finances; and
- ambition.

63 <http://www.philanthropycapital.org/downloads/pdf/Turning%20the%20tables%20in%20England.pdf>

64 <http://www.thirdsector.co.uk/News/DailyBulletin/1005925/Grading-system-charities-garners-support/3D1CF46175DBD7A77518FB6E4EF55969/?DCMP=EMC-DailyBulletin>

65 http://www.philanthropycapital.org/publications/improving_the_sector/charity_analysis/little_blue_book.aspx

The Little Blue Book also contains a grading grid, which can be used to qualitatively describe a charity's effectiveness on each part of the framework.

Department for International Development's (DFID) Approach to Partnership Working⁶⁶

DFID leads the British government's fight against world poverty. DFID supports civil society organisations through their country offices and centrally-managed funds, the latter including the Partnership Programme Arrangements (PPAs).

PPAs were established in 2000 to improve funding arrangements with 10 large UK-based civil society organisations (CSOs). They now provide unrestricted funding to (CSOs) with which DFID has a significant working relationship, a common ethos and vision and a strong match in priority areas. These include both UK and non-UK organisations. PPA funding is linked to a set of strategic level indicators – which the organisation is accountable for delivering over the 3-6 year time frame. Within this, however, the organisation is able to meet these objectives in the most appropriate way it sees fit.

- 8. Social enterprises which are not charities and are not therefore subject to the same regulation should consider the same informational / performance reporting recommendations and build them into their own practices.**

In general, we do not recommend any expansion of regulation for social enterprises. Those that are not charities are not subject to charity regulation (and equally do not have access to the charity public "brand" nor to certain fiscal privileges). We do though recommend to them that they should consider upgrading their performance reporting for similar reasons of enhancing their relationships with funders, enhancing perceptions of the quality and not just quantity of their performance and for the opportunity to shape how they are perceived and assessed.

⁶⁶ <http://www.dfid.gov.uk/Working-with-DFID/Funding-opportunities/Not-for-profit-organisations/PPAs/>

Appendix I:

Taskforce Members and Terms of Reference

The Taskforce Members:

Rupert Evenett	Chair; BTCV Taskforce Chair
Nick Aldridge	CEO, Missionfish
Sharon Allen	CEO, St Anne's Community Services
Hanneke de Bode	Senior Adviser on European Affairs, Euclid Network
Kevin Carey	Chair, Royal National Institute of Blind People (RNIB)
Keith Faulkner	Chair, Working Links
Richard Johnson	Managing Director, Serco Welfare to Work
Kate Sayer	Partner, Sayer Vincent
John Stewart	Head of Legal & Company Secretary, Wellcome Trust
Matthew Thomson	CEO, London Community Resource Network

Each of the members of the Taskforce is acting in her or his own personal capacity.

Taskforce Terms of Reference

High Level Stage

- To review the current regulatory framework for the English charitable sector
- To set out a vision for how the charitable sector should be regulated in the 21st century
- To make proportionate high level recommendations to strengthen regulatory outcomes for the charitable sector

Supplementary

- To review best practice from other UK based regulators and what may be transferable to the regulation of the charitable sector.
- To review examples of not for profit regulation across the globe and examine items may be transferable to the English sector.