Accounts Monitoring Review

Reductions in permanent endowment funds

About our accounts monitoring reports

Charities' accounts are publicly available on our website. Each year, we monitor a sample to check compliance with the Charities Statement of Recommended Practice (SORP) and to identify issues of regulatory concern. We are publishing a series of reports on our findings, which will help trustees to manage the risks that their charity faces and improve reporting standards.

The scope and purpose of this review

This review looked at the accounts of charities whose permanent endowment funds have reduced in value. We chose this area because of a perceived risk that, as access to public funding and fundraised income becomes more difficult, charities may decide to spend the capital element of their permanent endowments. Permanent endowment funds form an important element of the funding base for charities and there are also legal restrictions over how such funds may be used.

Endowment funds are capital funds held on trust for the benefit of the charity. They may consist of investment assets which generate income for the charity and/or assets that are used for the charity's purposes, such as buildings. Where the trustees must maintain the whole of the fund, it is known as permanent endowment. Where the trustees have the power to convert the capital into income, it is known as expendable endowment.

The fact that the value of an endowment fund has reduced does not in itself mean that some of the capital element has been spent. In particular, any losses on investments and the depreciation charges on buildings would be borne by the endowment fund to which they belong. A reduction in value is also possible where a charity has the power to adopt a total return approach to investments.

How we carried out the review

We used the information in Part B of the Annual Return to identify charities that had reported a reduction in the value of their endowment funds in their most recent accounts, those with a year end during 2012 in most cases. Part B provides summary information from the annual accounts, including the value of endowment funds held. Only charities with an annual income of over £500,000 are required to complete Part B and therefore our review has only considered these larger charities.

We identified 503 charities whose accounts showed a reduction in the level of endowment funds on the previous year. We then randomly selected 100 of those charities for follow up. The Part B information does not distinguish between permanent and expendable endowment. We therefore reviewed each charity's trustees' annual report and accounts to identify those which held permanent endowment and the value of which had reduced since the previous year. This identified 60 charities, which we reviewed in more detail.

What we found

The amount by which permanent endowment funds have reduced in value

The total reduction in value in permanent endowment funds across the 60 charities was £53.7m. This represents 7% of the total value of the permanent endowment funds of £748.6m that those charities had previously held. However, one charity was responsible for more than 60% of the total reduction. The scale of the individual reductions in value across the sample is shown in the table.

Reduction in permanent endowment funds	Number of charities	Total reduction in permanent endowment funds
More than £4.0m	1	£34.7m
£0.5m - £4.0m	10	£15.2m
Less than £0.5m	49	£3.8m
Total	**60**	**£53.7m**

The reasons why permanent endowment funds have reduced in value

All of the charities had disclosed the reasons for the reduction in value of their permanent endowment funds in their annual reports and accounts. There was no evidence that the capital element of those funds had been spent. The reasons for the reductions in value can be summarised into two categories:

- Charities where the reduction was due to depreciation, investment losses and the application of the total return approach. This group comprises all of the charities with a reduction of less than £0.5m and five of those with a reduction of between £0.5m and £4m.
- Charities which had reclassified some or all of their permanent endowment funds as either restricted income funds or into unrestricted funds, both of which are easier for charities to spend. This group comprises the remaining six charities.

What action we took

We reviewed our correspondence with the six charities that had reclassified their permanent endowment funds and, where necessary, contacted them to obtain further information about the reasons for their decisions and the advice the trustees had taken. We found that:

- Two charities had based their decisions on legal advice that they had received from us
- Three charities had based their decisions on their own legal and/or accounting advice concerning the terms of the original bequests

- One charity had based its decision on its own accounting advice concerning the application of a different SORP which governs the sector in which it operates. This is the charity that reported a £34.7m reduction in the value of its endowment funds.

We identified no cause for regulatory concern. However, the £34.7m transfer was the result of the charity's interpretation of a SORP for which we are not the regulator. That SORP makes different requirements for accounting for endowment funds to the Charities SORP. We have therefore drawn the issue to the attention of the regulator of that SORP.

Lessons for other charities

While we did not identify any issues of regulatory concern, the findings from our review act as a reminder to trustees that they should consider taking professional advice if there are uncertainties over the status of their permanent endowment funds.

While the original intention of a permanent endowment is that the property or money would be held by a charity forever, the law recognises that this may not always be practicable. For example, it may be that trustees can identify more effective ways of using their permanent endowment funds to achieve their charity's objectives. If this is the case, a charity may be able to spend its permanent endowment, although our permission is likely to be required. Further guidance is available on our website.