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Not for Profit eNews

November 2023

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November 2023 eNews

Welcome to the latest edition of MHA Not for Profit eNews.

Welcome to the latest edition of our newsletter! We have an exciting lineup of topics to share with you this month.

First up, we'll be discussing the project for international standards for not-for-profit organisations. As we reach the second consultation of the project, we'll be taking a look at what this means for the future of not-for-profit organisations and how you can get involved.

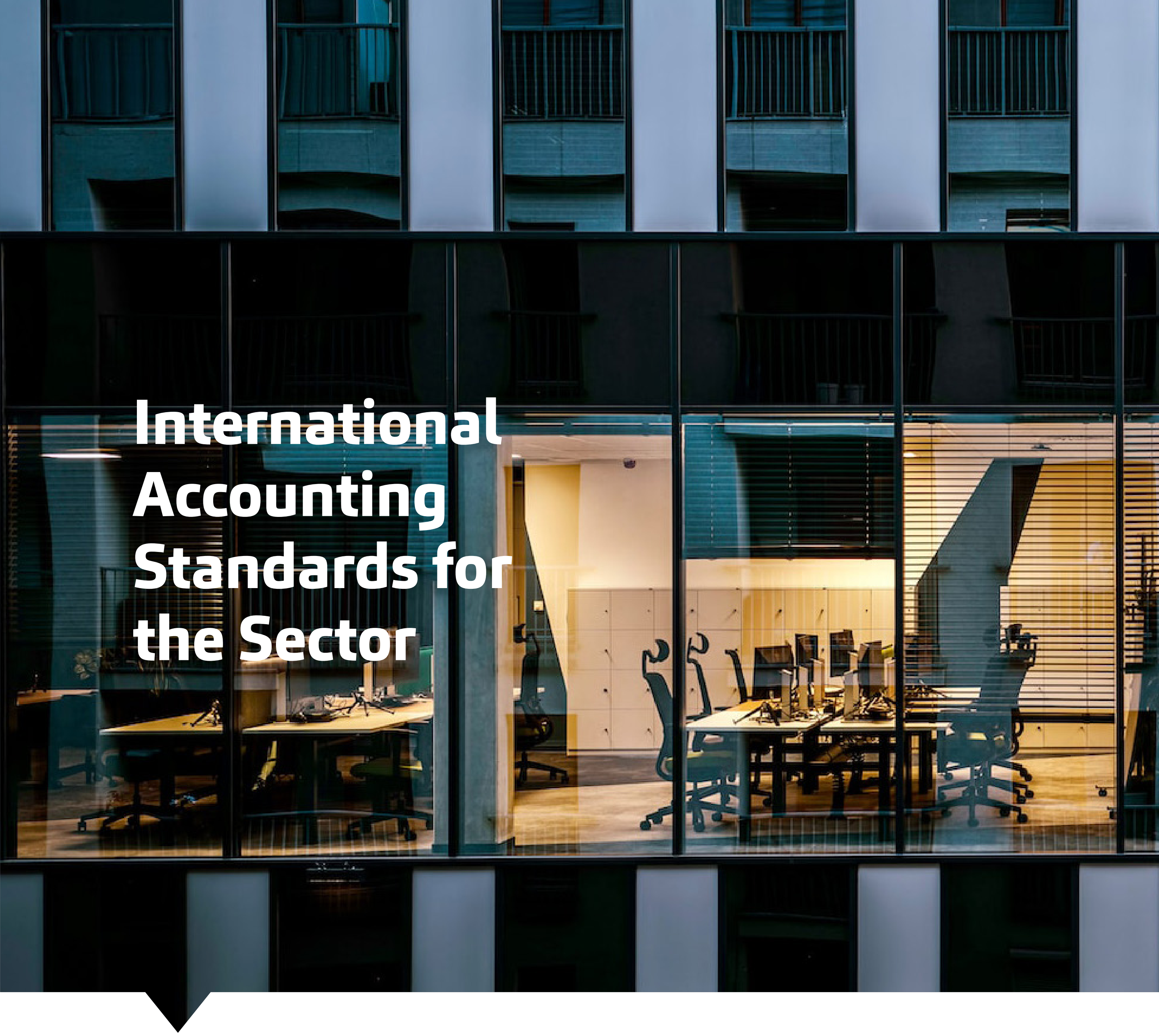
Next, we'll be uncovering the government's plans to regulate AI. With a focus on "responsible use", these plans are set to have a significant impact on the not-for-profit sector.

Finally, with the support of Ecclesiastical, we'll be turning our attention to avoiding the copyright web.

As ever, if there are any points you wish to discuss further in this issue please do get in touch.

Best Regards,

MHA Not for Profit team



International Accounting Standards for the Sector

There are currently no international standards for not-for-profit organisations which is why the International Financial Reporting for Non-Profit Organizations project was launched in 2019. This five-year project aims to develop the first-ever international financial reporting guidance for not-for profit organisations, which can command support from the accounting community, not-for-profit organisations, funders, and regulators alike.

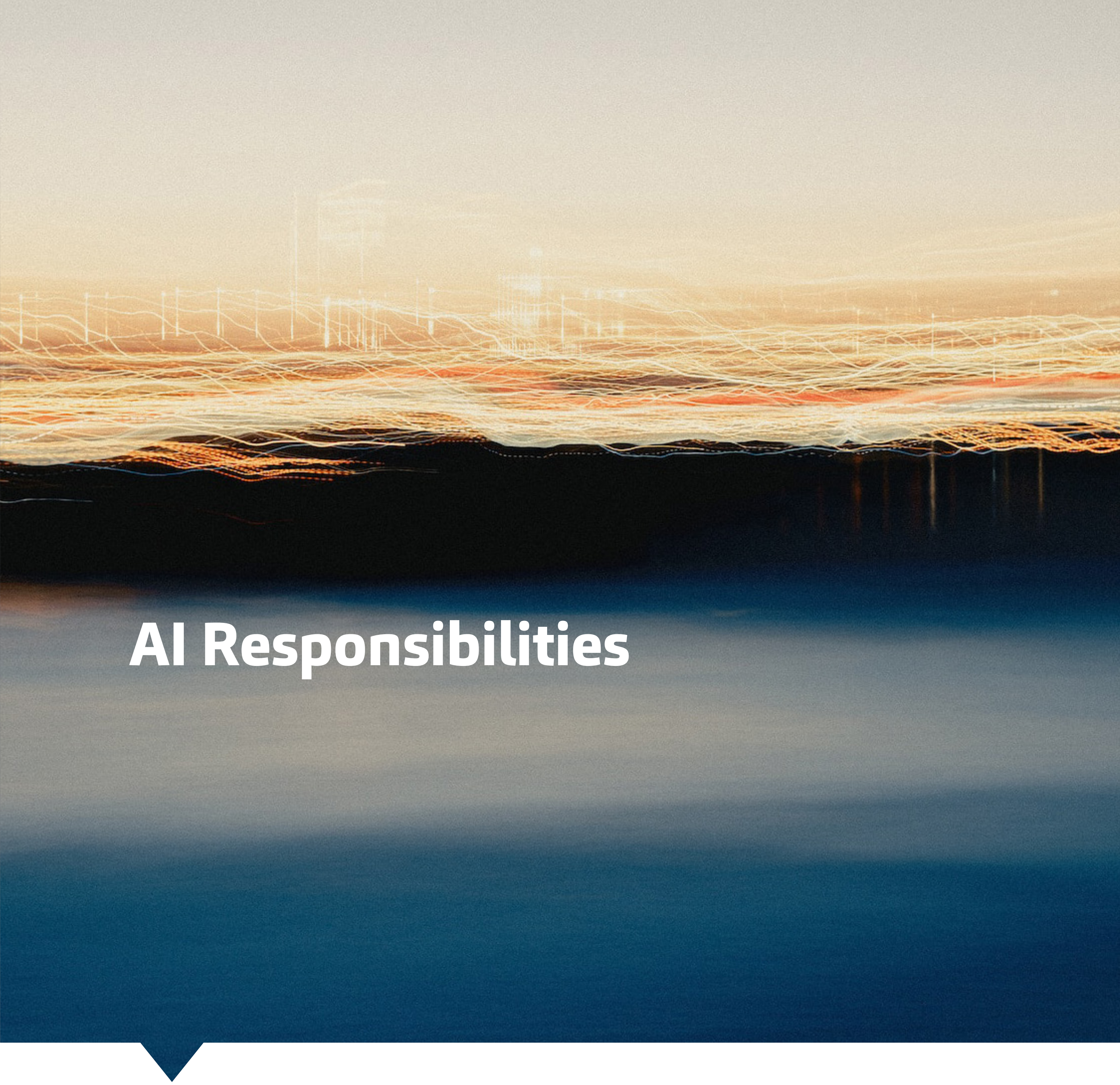
The project is run by the Chartered Institute of Public Finance and Accountancy and Humentum, a global not-for-profit organisation working with humanitarian and development organisations.

The project has reached the second of three consultations on proposed international accounting standards for the sector. The first exposure draft ran from November 2022 to March 2023, covered general financial reporting issues as well as sector-specific accounting issues. The second exposure draft for the project remains open for public comment until March 15, 2024, and covers four sector-specific accounting issues:

1. income from grants and donations,
2. grant expenditure,
3. stock, and
4. foreign currency translation.

This is a fantastic opportunity for the sector to contribute their views and shape the future of financial reporting for the not-for-profit sector.

The third exposure draft is expected to cover presentation issues. The final guidance is planned for publication in mid-2025.



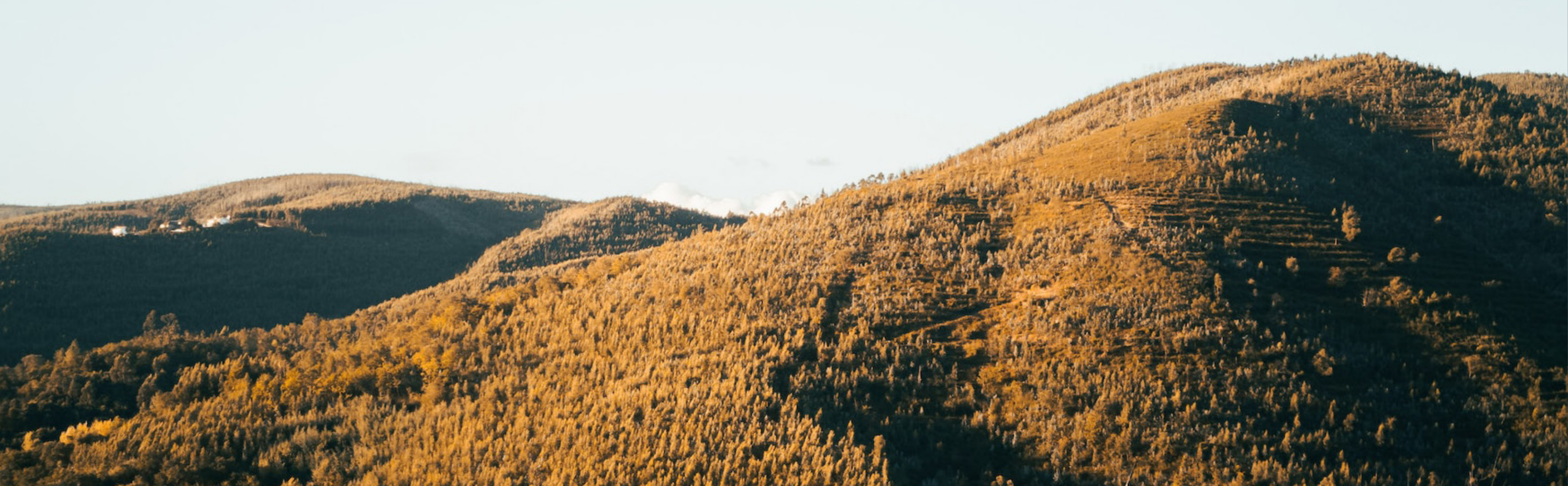
AI Responsibilities

The UK government has recently published a white paper on Artificial Intelligence (AI) regulation, which outlines the government's approach to regulating AI in the charity sector. The paper states that sector-specific regulators will be responsible for implementing the government's AI framework, which will be underpinned by "a set of principles that will drive consistency across regulators while also providing them with the flexibility needed".

At a Charity Forum event in September 2023, sector consultant Zoe Amar said that the Charity Commission and Fundraising Regulator will be responsible for issuing guidance on the technology and regulating it.

The aim of the regulations is to support innovation whilst providing guidance to help identify the associated risks of AI. The government's approach is based on five principles that the regulators should consider to enable the safe and innovative use of AI in the industries they monitor. These principles include transparency, security, robustness, safety, accountability, and fairness.

This new approach is a significant step forward in regulating AI systems and outputs that have an impact in the sector.



VAT on Private Schools Fees & a Labour Government

Bridget Phillipson, the Shadow Education Secretary, said the following in early 2023:

"Labour will put our children, their futures, and the future of our country first by asking those with the broadest shoulders to contribute their fair share by requiring private schools to pay business rates as state schools already do and to pay VAT as our colleges already do. Labour would use the funds raised by removing private schools' tax exemptions to recruit 6,500 more teachers, as well as to offer additional teacher training and careers advice and work experience for all pupils."

How much will this raise?

The Institute for Fiscal Studies (IFS) has recently published a report in July 2023 entitled **"Tax, private school fees and state school spending"**. The report estimates that the proposed change may raise an additional £1.7bn in VAT.

To obtain this estimate, the IFS has used data provided by the Independent Schools Council for the 2022-23 school year. The IFS has assumed that:

- Total fee income is £10.2bn
- That 20% of private school costs are subject to 20% VAT.

This leads to a gross yield of £2bn VAT reduced by £340m VAT on costs and a net yield of £1.7bn. There are further assumptions and estimates for specialist provision and boarding fees, which can be accessed in the IFS report. School fees are exempt from VAT, which means no VAT is charged and no VAT can be recovered. To calculate the net change, the IFS has correctly calculated both the VAT due and the VAT which is currently suffered as a cost.

How and when will this happen?

HM Treasury ("HMT") would need an Act of Parliament to change primary VAT legislation. Specifically, HMT would need to change the definition of an "eligible body" in Note (1), Group 6, Schedule 9, VAT Act 1994. The definition of eligible body in Note (1) relies on several Education Acts, together with other separate qualifying criteria, which include a restriction on the distribution of profits.

It should be noted that in consultation with the education sector, HMT and HMRC have previously tried and failed to remove several anomalies from the VAT exemption for the provision of education.The combination of archaic legislation, the need for parliamentary scrutiny of any changes, a reasonable consultation process, and a lead time for such a fundamental shift in tax treatment will cause a delay to any changes. It is impossible to be certain, but given the bottleneck of parliamentary time, our best estimate is that these changes will not be introduced until at least the payment of fees for the 2026 – 27 school year. This estimate assumes that the General Election will take place no earlier than the fourth quarter of 2024.

Will this impact all income earned by the school?

The target market for this measure is the fee-paying independent sector, which includes both day schools and those which accept boarders. HMT may consider that the removal of the VAT exemption for education will alsoremove the exemption for closely related goods and services, as these are exempt by reference to VAT statute. HMRC guidance provides the following definition of "closely related":

- "For the direct use of the pupil, student, or trainee.
- Necessary for delivering the education to that person."

HMRC guidance provides the following examples to fit the above definition, "accommodation, catering, transport, school trips, and field trips."

In our view, it would be a mistake to assume that all additional goods and services will be subject to VAT. In the absence of legislative provisions driving the VAT exemption, the treatment of linked goods and services should be determined by the wealth of HMRC guidance and leading case law on the definition of single and multiple supplies.The starting point should always be that every supply is taxed on its own merits unless it is inextricably linked to an overarching supply.

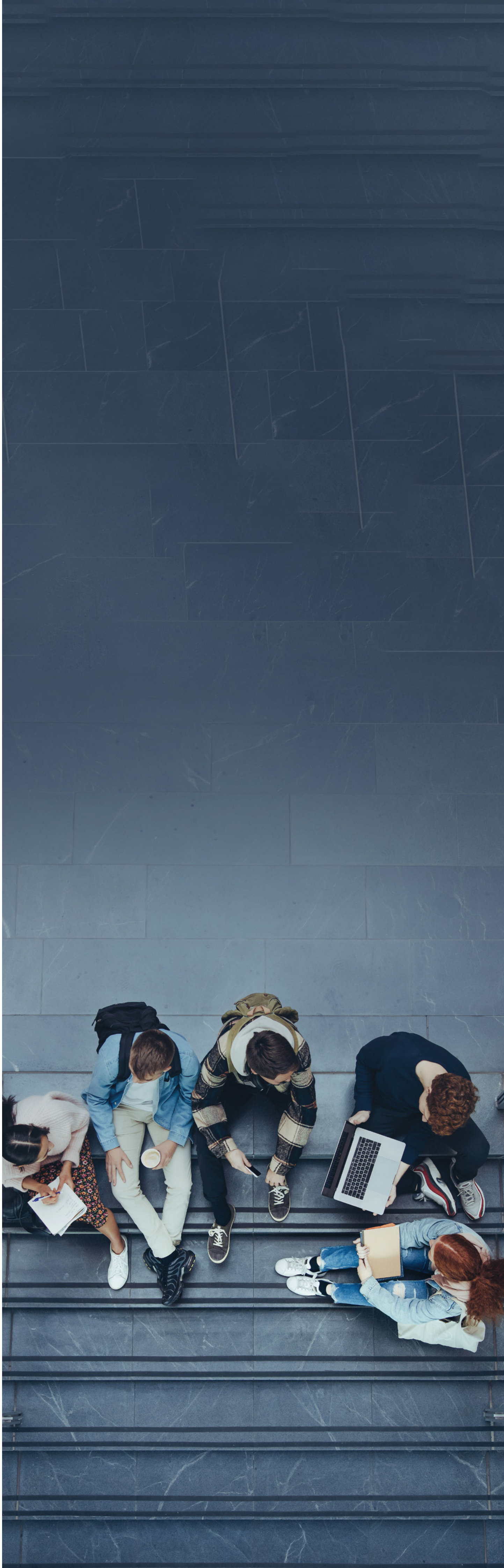
How best to prepare for this change?

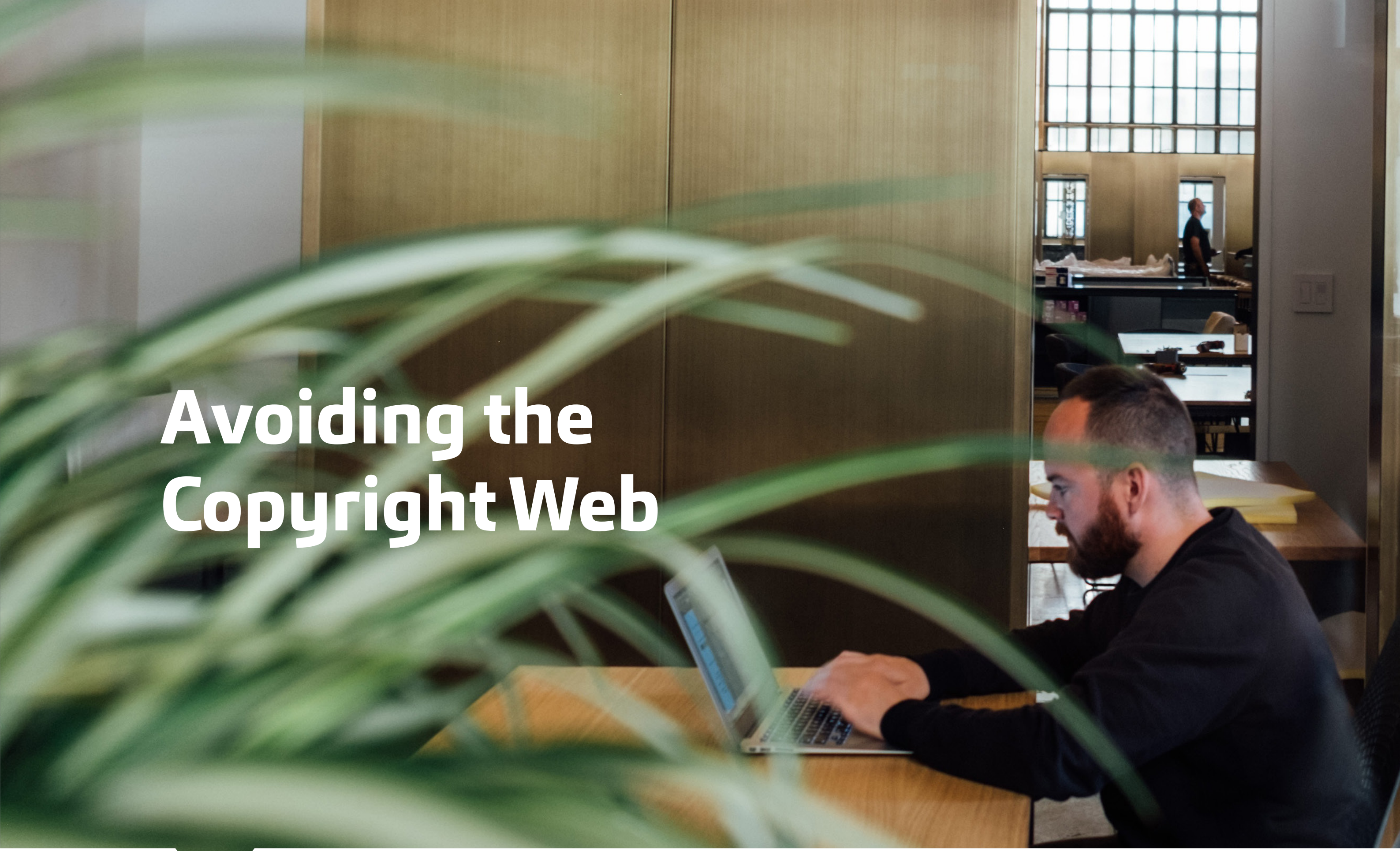
The most important action is to stress test the profitability of your business model on the assumption that the change could be introduced from the 2026 – 27 school year. To allow you to carry out this exercise, you should:

- Review accounting systems and processes to ensure that you separately record all additional revenue earned in addition to school fees.
- Separately itemise VAT on all costs incurred to ensure that you maximise the recovery of VAT on your costs.
- Keep a record of past capital spend, as elements of this may be eligible for VAT recovery.

A change mindset is required to deal with this change. Rather than a desire to include additional revenue under the banner of VAT exemption, you would be better served by viewing additional revenue as discretionary spend by the pupil, parent, or guardian if that revenue would not ordinarily be subject to VAT.

This is not VAT avoidance, merely the application of VAT law and practice to your particular circumstances.





Avoiding the Copyright Web

With a cost of living crisis impacting the day-to-day running costs of a charity together with volunteer and staff shortages, charity leaders have a lot on their minds. Understandably, the tiny details of day-to-day charity operations, such as checking the image rights for the front cover of the monthly newsletter, may be missed.

And yet that image could end up costing the charity thousands of pounds. Breaching copyright is considered an emerging threat to the sector, alongside data breaches. In a recent Ecclesiastical Insurance survey of charity decision makers, a fifth of charities have grown more concerned about these two risks since 2022[1]. Copyright infringement is an area that many charities either don't think about or don't consider a potential risk. This attitude could end up costing them dearly.

What is copyright?

Copyright is legal right that protects the expression of an idea, rather than the idea itself. There's no copyright on the view of a tree in front of a lake, for example. However, if a photographer chooses what they consider the perfect lens, light setting and angle for the shot, and edits the image afterwards, the result is an artistic expression that is potentially protected by copyright. Expression can take the form of an image, video, illustration, literary work or piece of computer code, amongst others. A copyright infringement occurs when copyrighted material is used without permission. In a digital world, this is worryingly easy to do.

Let's say a charity uses our lake view picture to illustrate a blog on its website. It may not consider the possibility of a copyright breach for several reasons:

1. The image isn't copyrighted, because it's not displaying the copyright © symbol.
2. It's on the internet, where content is generally free.
3. It has charitable status – so there may be an exemption in law.
4. It is a small charity with limited reach and income – even if there is a copyright holder, they won't see it or think it is worth pursuing a claim.

Unfortunately, none of this stands up.

A dangerous view

Views 1, 2 and 3 are common myths. View 4 may convince charities that, whilst the theoretical risk is real, the chances of being sued for copyright breach are slim to non-existent.

They're too small, too poor, or too obscure. The internet is too big. They're a charity – who would take money from a worthy cause over a blog post?

This is a dangerous view. As a specialist insurer, Ecclesiastical Insurance have noticed a rising number of Professional Indemnity claims due to copyright infringement since the pandemic. Over a quarter of claims in the past three years have been for either data breach or copyright infringement.

The impact of these claims on charities can be sizeable – not just in terms of potential financial impact, but also reputationally too,"

says Faith Kitchen, Customer Segment Director at Ecclesiastical Insurance.

"There is additionally the challenge of the time and effort taken to deal with a claim like this, which can put pressure on staff and volunteers."

A growing problem

Copyright infringement is a growing problem, probably because the pandemic forced more charities to do more online. Smaller charities may not be aware of copyright laws. Charities of any size may be trying to do more with less in difficult times.

But copyright owners are more clued up now than ever. Powerful tools can help them trace copyrighted material across the internet. An archived newsletter may be hidden from human eyes, but not from digital ones. Owners or their representatives may come after even a small charity because they assume their insurer will pick up the tab.

"Another issue is the international nature of online content," says Nick Gibbons, Legal Director at global law firm Clyde & Co. "A charity might believe that under English law any damages will be negligible. But if the image can be viewed abroad, foreign laws may apply. In Germany, for example, there's a completely different way of assessing damages, which can run to thousands of euros."

The need for good content to fundraise

So the risks are real, but at the same time, good content is essential for fundraising, user experience and stakeholder communications. How do charities create engaging online content without risking copyright infringement?

- Train relevant staff, volunteers and third parties about the risks of copyright infringement.
- Look for royalty-free images on sites like Canva, iStock and Shutterstock and equivalents for audio.
- Gain the permission of the subject owner when taking photographs – this includes taking photos of other people's works.
- Create resources in-house. These days, good images and video are only a phone camera click away.
- Get protected and put relevant insurance cover in place.
- If in doubt about any piece of content, don't use it.

Take legal advice - other parties sometimes target charities, claiming to act on behalf of copyright holders. Organisations that create large amounts of content may also want to take a more strategic approach.

"Adopting an Enterprise Risk Management approach can help build resilience," says Sarah Pearson, Head of Enterprise Risk Management at Ecclesiastical. "In this context it might include deep dives into the causes of copyright risks, what the consequences might be, current controls and if more needs to be done."

Charities rarely set out to steal copyrighted material, but ignorance is no defence and even inadvertent use can lead to serious consequences. As a default position, a charity should assume everything created is traceable, and not use content unless certain of its copyright status.

1 Ecclesiastical charity sector survey 2023 conducted by YouGov, based on 251 charity decision makers.

The above article was created by Ecclesiastical Insurance Office plc. Advice on Charity Insurances can be obtained from MHA's insurance partner, Insurance Services Surrey – please speak with your usual MHA contact for more details.

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MHA Not for Profit Team
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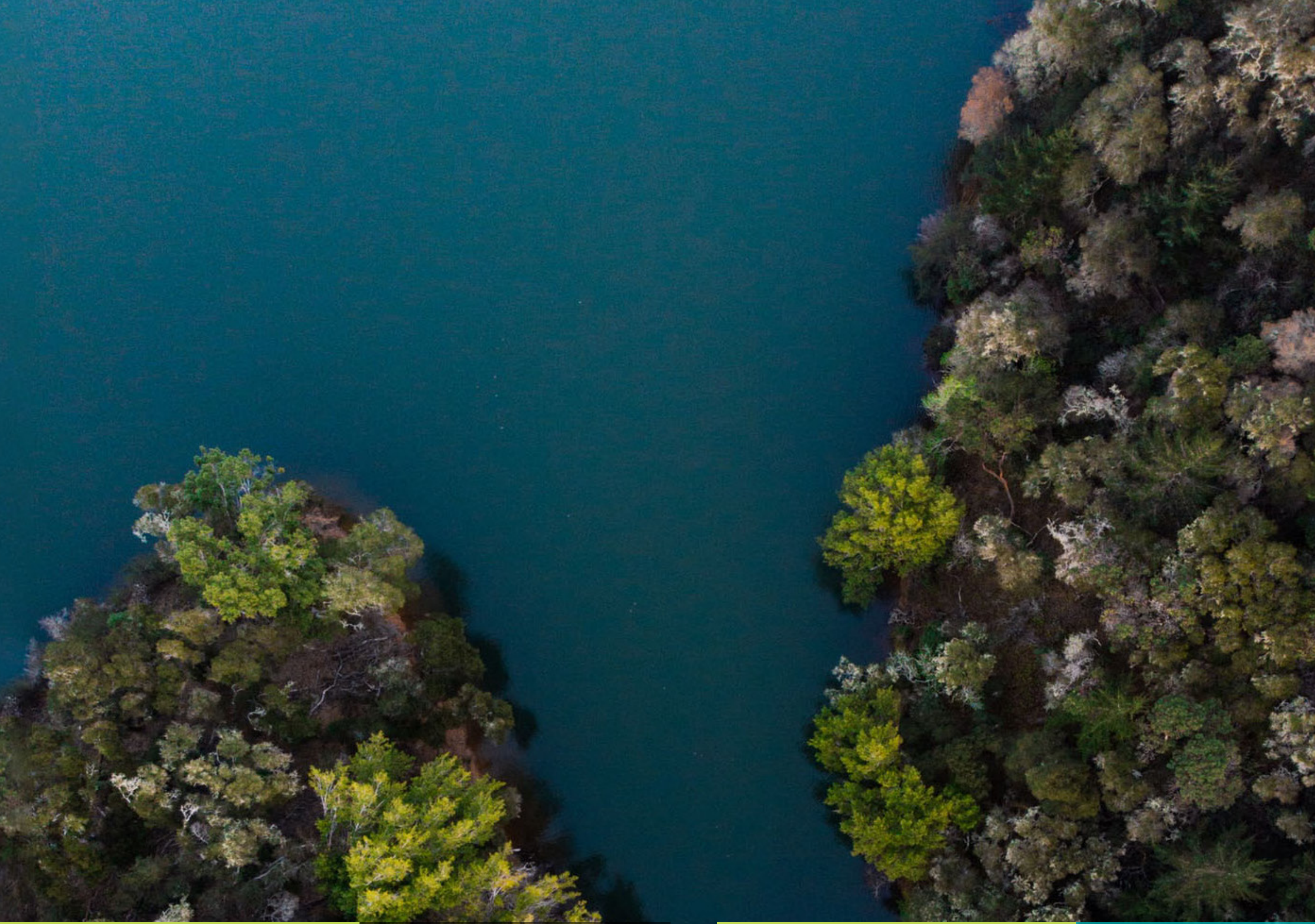

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