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Charities Alert.

Accounting considerations related to the Coronavirus 2019 (COVID-19) pandemic

Summary of useful links

- The Charity Commission for England and Wales (CCEW) set up a web page on 19 March 2020 to provide additional guidance for charities, https://www.gov.uk/guidance/coronavirus-covid-19-guidance-for-the-charity-sector. This was updated and re-issued 7 April 2020 and now includes more information on government funding and support available to charities.
- CCEW's approach to regulation during this uncertain period will be as flexible and pragmatic as possible in the public interest, whilst helping trustees to be aware of and think about the wider or longer impact of their decisions on their charity.
- Specific guidance for charities and trustees on the accounting implications was issued on 23 March and can be found on the SORP microsite. https://www.charitysorp.org/media/648486/sorp-covid-19.pdf. This includes considerations around going concern and the disclosure of post balance sheet events, as well as the accounting for income, contracts and commitments.
- Guidance from the Financial Reporting Council (FRC) which includes guidance for companies and auditors can be found at https://www.frc.org.uk/about-the-frc/covid-19 and addresses some of the difficulties companies currently face in making forward-looking judgements in their financial statements.
- The government has set out a number of measures to support individuals and organisations in this crisis. A summary of these can be found at https://www2.deloitte.com/uk/en/pages/financial-advisory/articles/covid19-uk-government-funding-response.html.
- Guidance for charities registered in Scotland was published by the Office of the Scottish Charity Regulator (OSCR) on 30 March and is available at https://oscr.org.uk/guidance-and-forms/covid-19-guidance-for-charities/.
- General accounting guidance for all types of companies can be found in the Deloitte summary https://www.iasplus.com/en-gb/publications/uk/need-to-know/2020/need-to-know-coronavirus.

Introduction

The coronavirus 2019 (COVID-19) pandemic is affecting economic and financial markets, and virtually all industries are facing challenges associated with the economic conditions resulting from efforts to address it. For example, many charities have seen sharp declines in revenues due to the closure of retail outlets or from the cancellations and delays in fundraising events due to regulatory and organisational mandates (e.g. "shelter in place" mandates, school closures) and voluntary changes in consumer behaviour (e.g. "social distancing").

As the pandemic increases in both magnitude and duration, entities are experiencing conditions often associated with a general economic downturn. This includes, but is not limited to, financial market volatility and erosion, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand, layoffs and furloughs, and other restructuring activities. The continuation of these circumstances could result in an even broader economic downturn, which could have a prolonged negative impact on the country, both increasing the need for charitable operations and increasing the challenge of fundraising and delivery. This briefing highlights some of the financial accounting and control impacts that trustees will need to consider. Due to the wide variety of income streams and activities this alert does not aim to cover all issues that may be affecting charities as a result of the COVID-19 pandemic but seeks to provoke management and trustee challenge of the individual circumstances of each charity.

> The measures involve a high degree of social disruption which has an impact on the delivery of and demand for the activities of charities, the availability of staff for work, and levels of illness across society which will affect the beneficiaries of charities. There are therefore potential implications for charity income, expenditure and commitments, and the value of charity assets and liabilities. In some cases the implications may be so severe as to cast doubt upon a charity's financial sustainability. *(CCEW guidance March 2020)*

Accounting and reporting

Trustee reporting

As all charities react to and manage this new (temporary) reality, the risks of the activities and the plans for the future will be constantly under review by trustees and management. Risks mitigated and activities re-planned or renegotiated and those decisions and their effects will need to be reported. For charities whose year end has passed but whose accounts are not yet signed it is likely that there will be an impact on the disclosures made, not only to post balance sheet event disclosures and those relating to going concern which are considered below but also to the trustees' principal risks and future plans reflecting these new assessments.

As charities move forward, the CCEW guidance also provides a checklist of areas not only for trustees and management to consider but also upon which they would expect additional comment in the trustees' reporting for the financial statements directly affected by the COVID-19 pandemic.

How has the outbreak of the virus affected staff, volunteers and beneficiaries and the implications for the charity's operations and activities for the coming year?	How have virus control measures affected the charity's activities?
What are the financial uncertainties (if any) regarding the charity's financial sustainability and the steps being taken to address these uncertainties?	How has the contribution of volunteers (where appropriate) assisted the charity in its work in managing the changed circumstances?
What is the impact on the charity's ability to fundraise and how are the trustees managing this situation?	How have the financial and operational effects of the virus and the control measures relating to the virus affected the principal risks and uncertainties facing the charity during the reporting period?
Are there any implications for any existing or potential defined benefit pension liability and investments the charity holds?	What is the impact on the charity's reserves policy, level of reserves and any change to designated funds set aside for future commitments?
What is the likely impact of the virus control measures and potential duration of the control measures on the future aims and activities of the charity?	What is the impact of the virus-related control measures on any wider network of which the charity is a part and how this affects the charity's operations?

Adjusting or non-adjusting post balance sheet event

For those preparing accounts for December 2019 year ends or earlier there will be different considerations than for those with later year ends as the pandemic for those entities will typically be considered a non-adjusting post balance sheet event (with the exception potentially of those charities operating in China or other early affected areas). As a result it is unlikely to impact directly on the financial statement balances. The CCEW guidance highlights loss in value of assets (for example assets used in service delivery or retail stock) or material fall in the value of investments as two possible non-adjusting impacts that would require disclosure. However, that is not the end of the potential impact. It is likely up to this point that the accounts will have been prepared on a going concern basis: trustees must now reconsider their judgments and assumptions to ensure that the going concern basis remains appropriate. For charities with January and February year ends, depending on the charity's operations, the impact of the increasing measures to manage the pandemic may be deemed to have an impact on the balances at the year end for example value of stock, recoverability of debtors. The SORP describes in section 13.4 adjusting events as those events occurring after the end of the reporting period but before the accounts are authorised for issue which provide evidence of conditions existing at the reporting date which affect items in the balance sheet and items reported in the statement of financial activities. Charities must review and amend the amounts recognised in the accounts and any related disclosures in the notes to the accounts to reflect adjusting events. New information suggesting the charity was not a going concern would also be part of these considerations.

Going concern

When reporting in uncertain times, it is particularly important to provide users of the financial statements with appropriate insight into the entity's resilience in the face of the current uncertainty and to understand the key assumptions and judgements made when preparing financial information. There is an expectation by regulators that there will be more material uncertainties reported.

Relevant judgements and assumptions might include the:

- availability and extent of support through government support measures that have been announced (there may be issues in establishing what can be recognised and when, depending on the certainty over receipt of the funding, compliance with the conditions and confirmation received);
- availability, extent and timing of sources of cash, reflecting the nature and variety of the charity's income streams (and including compliance with banking covenants or reliance on those covenants being waived where applicable); and
- duration of social distancing measures and their potential impacts.

There is not a single view on how the COVID-19 pandemic will evolve and its impact on the economy. This lack of consistency makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual.

COVID-19 is disrupting operations of many businesses. Entities will need to consider whether such disruption will be prolonged and result in:

- significant liquidity shortfalls through:
  - fundraising events being cancelled or postponed (for example the London Marathon)
  - significant reductions in the ability to operate (closure of retail outlets)
  - significant reductions or non-delivery of planned activity (services delivered through schools or in face to face settings)
  - increased demand for services and support as beneficiary hardship levels increase with limited staff and volunteer availability
- reduction in asset values due to assets not being in use or changes in ways of working when the measures are removed; and
- legal or contractual implications of agreements, income or expenditure, if obligations cannot be met.

The importance of reserves to all charities (and other organisations) has never been so stark. Whilst there is government support available and support within the sector itself as well as changes in activities that may mean cost savings or deferrals, immediate shortfalls may need to be met by drawing on reserves. These considerations and the impact of other significant changes in the operations will influence management's assessment of whether the entity may be able to continue as a going concern for at least, but not limited to, 12 months from the date of signing the trustees' report and financial statements.

Financial statements are prepared on a going concern basis unless trustees intend either to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When making its assessment, if the trustees are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the trustees must disclose those uncertainties in the trustees' report. The existence of such uncertainties is also likely to require reporting to the Charity Commission.

Financial review

1.23 If, at the date of approving the report and accounts, there are uncertainties about the charity's ability to continue as a going concern, the nature of these uncertainties should be explained. *(SORP 2019)*

Where there are material uncertainties the auditor will make reference to these in the audit report and report this to the Charity Commission as a matter of material significance reportable to UK charity regulators.

Internal controls

Charities will already have an internal control framework in place to prevent and detect fraud. However, COVID-19 has caused significant operational and financial disruption, resulting in increased pressures on services, employees and beneficiaries at a time where the control environment of the entity may be weakened.

Management should update their understanding of their internal controls to identify which controls still operate effectively and which cannot work in this new environment. Management should then put in place controls to cover the gaps identified. This re-assessment should consider specifically whether there is a heightened risk of fraud as a result of the impact from the spread of COVID-19, whether that is through manipulation of financial results, misrepresentation of facts or misappropriation of assets. This assessment should document any changes that have been made to the internal control environment to allow the continuing operation of the business and how these have been designed to mitigate the risk of fraud. Such an expectation equally applies to trustees in terms of a reconsideration of the risk of management fraud. It is important management include not only their response to the current situation, but continue their assessment through the recovery process as different risks and motivations for fraud may arise. This management assessment should receive robust challenge from trustees, so they can satisfy themselves they have met their financial duties as trustees having robust and effective financial controls in place and protecting the charity from financial crime such as theft or fraud.

> You and your co-trustees are responsible for your charity's money. Your charity should have effective processes for handling money, to help avoid poor decisions and accidental errors, as well as theft and fraud. Failure to do so is likely to result in a breach of your duty. You should:
>
> - set a budget and keep track of it
> - put in place clear policies and procedures to deal with income and expenditure
> - ensure the charity keeps accurate records of income and expenditure
> - have robust and effective **financial controls** in place
> - protect the charity from **financial crime such as theft or fraud**
> - put appropriate safeguards in place for money, assets and staff if the **charity operates outside of the UK**
> - have an appropriate **reserves policy**
> - ensure the charity receives **tax reliefs** to which it is entitled
>
> *(CC3 The Essential Trustee: 7.5 Managing funds and keeping them safe)*

pressure ▸ **rationalisation** ▸ **opportunity** ▸ **manipulation** ▸ **misrepresentation** ▸ **misappropriation** ▸ **override of controls**

Management and trustees will need to keep their understanding of internal controls and fraud risk assessment updated as events change over the coming period. The assessment and evidence of challenge by trustees should be clearly documented. Wherever possible it is important to maintain segregation of duties. However, if for a short time this is not possible, say due to illness, management and trustees must have early warning and monitoring mechanisms in place to ensure the lack of segregation of duties is not abused.

What charities can do

Care should be taken to preserve and strengthen the control environment as charities work remotely:

- Maintain segregation of duties so that no one individual has too much authority to post inappropriate journals, make payments and misappropriate cash or other assets.

- Ensure proper accounting records are still maintained. Consider requesting third parties send data to more than one employee so it can be subsequently cross checked for changes if required.

- Think about ways to secure the charity's assets using technology where physical controls cannot be implemented. Consider more digital security such as CCTV and electronic tagging of assets.

IT controls are important too. With increased home working and remote access to company systems controls need to make sure only the right people are accessing the right systems. Home networks may not have the same security and firewall defences as office environments. Regular activity log reviews and increased cyber awareness are recommended to identify unexpected behaviour. Similarly, administrative functions which may normally be restricted to a few privileged individuals may have been provided to additional staff to provide some resilience; it is important this is managed in a risk-aware manner for example through monitoring of activity and time-limited access. Whilst some or all of these controls may not be possible within an individual charity, trustees and management should consider how they are addressing the risks proportionate to their size and activities.

Next steps

We recommend that charities, management and trustees consider the questions raised above and satisfy themselves that risks, fraud or otherwise, have been identified, controls are in place and activities, plans, cash, commitments, liabilities and reserves can be managed.

Contacts

If you would like further, more detailed information or advice and to discuss how this will affect you, please contact your local Deloitte partner or:

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