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A clever move?



Undertaking a merger can have a number of advantages for not for profit organisations, especially in these challenging times when income streams are uncertain. It can also reduce the risk of dependency and help achieve critical mass. If the organisations are integrated correctly, it can not only enhance the offering of the combined entity but also make it more secure, provided there is a well-planned strategy and integration package in place.

The typical reaction to financial difficulties is to undertake a cost-cutting approach, reducing staff costs, employees and non-core expenditure. Whilst these responses are normally appropriate and can buy the organisation time, they are sometimes only a short-term solution and, as the recession continues, organisations may need to look for new creative, longer-term solutions to their financial problems. A merger may be one such solution, providing mutual benefits and synergies to both parties, creating a more robust enlarged organisation to confront declining conditions and fundraising capabilities.

Mergers can provide a safe-haven for organisations with fundraising and operating issues, while benefiting stronger organisations by:

- broadening the range of services they provided to their stakeholders;
- generating overhead savings and economies of scale;
- helping clients achieve critical mass;
- sharing best practice; and
- providing an increased robustness to weather the current economic downturn.

A successful merger requires a great deal of planning, time and effort, for a while a merger can provide many advantages, it can also be a potential minefield. The stages listed below give a guide to how to make the process as successful as possible.

Strategy and planning

Good strategic planning is absolutely vital when contemplating a merger. The prime aim of any transaction is that it fits with the long-term strategy of your organisation.

A clear idea of the desired attributes of your merger partner should be formulated, including type, size, location and charitable objectives. Potential suitors fitting these criteria can then be identified.

Identifying of potential partners

It is important to be proactive as it is unlikely that a golden opportunity will appear out of the blue. You will normally have to look for the right partner, although some transactions occur where organisations already work closely with one another and a merger evolves out of a strong relationship.

When assessing a potential partner, the following five factors should be considered:

- Is there a good fit between the charitable objectives of the two organisations?
- What will be the financial and charitable benefits of a merger?
- Is there a competent management team and how will the two teams fit together?
- What are the future commitments to expenditure and how are these matched by secured incoming resources?
- Are there any adverse external risk factors outside the control of the organisation?

Professional advisers

You should appoint advisers who have the appropriate skills, gained through experience of the acquisition or merger process. The job of advisers, in addition to ensuring the transaction is completed correctly and for the benefit of stakeholders, is to take on the bulk of the work and free up management time to concentrate on running the existing operations.

Preliminary due diligence

To ensure there are no major problems with the other organisation, preliminary due diligence should be conducted before any firm offer is made. Due diligence is an exercise performed to collate further information about the prospective merger partner. At this stage, it is a good idea to research their specific sector and understand the broad issues that they are facing. Be prepared for due diligence to be conducted on you as well.

Heads of agreement

When an agreement has been reached in principle, the next stage is to draft the 'heads of agreement', which summarise the principal terms of the transaction between you and the merger partner. It is important that this is tightly drafted with the help of financial and legal advisers in order to avoid misunderstandings on key points. It is especially important that communication channels are kept open throughout the negotiation process and until the transaction is closed.

Detailed due diligence

Once the terms of the merger have been outlined, normally within the heads of agreement, your accountants and lawyers will conduct a detailed investigation of the merger partner. This is to ensure the accuracy of the information made available to you and to highlight any issues that will need to be considered prior to completion. Essentially the due diligence will provide you with an independent assessment of the organisation and quantify areas of commercial and financial risk. Legal due diligence will also provide you with assurances on any contractual obligations.

Negotiation of the final terms

A thorough due diligence investigation should put you in a stronger negotiating position. If problems and weaknesses are identified they are likely to result in modifications to the final terms of the transaction, which will be drawn up as formal legal documentation. You should always bear in mind that there are two sides involved in completing the deal; try and see things from the merger partner's perspective too.

Post completion

Integration rarely goes as smoothly as anticipated, so it is important to draw up a plan and timetable of how this should progress. How the transaction should be announced must be agreed. The announcement should be made as soon as possible to both employees and stakeholders, emphasising the positive implications for them. Once this has been done you should start to implement the steps necessary to achieve your key objectives.

Practical tips for successful acquisition

- Summarise the main objectives of the transaction before you start the process.
- Ensure that sufficient resources are in place to complete the transaction.
- Ensure that the partner is capable of improving your existing organisation.
- Be patient. A methodical, complete exercise will provide a more successful outcome.
- Always undertake due diligence.
- When negotiating, be aware of the other side's objectives. Be reasonable and realistic in your demands.
- Have a plan in place to ease integration post acquisition.
- Do not spend too much time on the transaction at the expense of looking after your existing operation.

For further information please contact:

Matt Meadows, Kingston Smith LLP, at mmeadows@kingstonsmith.co.uk or Nick Brooks, Kingston Smith LLP, at nbrooks@kingstonsmith.co.uk

VAT on investment management fees

About a year ago one of the Nuffield charities publicised the fact that they had succeeded in reclaiming VAT on investment managers' fees to the extent that its investment income was supporting the VAT-able activities of the charity. This followed the argument of the Children's Society case concerning VAT on fundraising costs; and overturned the long-standing decision in the Wellcome case that the activity of managing investments was not in itself a business one. The result was that the input VAT on investment management fees was no longer disallowable, but partly recoverable depending on the circumstances.

Can you make a similar claim?

Following the Children's Society case, we put in a number of claims on behalf of clients but these were referred to HMRC Policy division to rule on the principle behind the claims. HMRC has finally agreed that such claims are valid and will issue a briefing about it in due course. Meanwhile, some of our clients have been paid in respect of claims already submitted. The ability to recover a proportion of input VAT on investment management fees depends on the nature of the charity's activities and what its investment portfolio is used for. Provided that part of the charity's activities are subject to VAT, and the investment income is used to support those activities, then it should be possible to submit a claim now in respect of input VAT not previously claimed, in accordance with the charity's normal partial exemption calculation. Currently, it is possible to make a retrospective claim going back up to four years, depending on your charity's circumstances.

What to do now?

If you think your charity may be affected by this new interpretation, it is worth making a claim before 31 March 2010 to obtain the maximum benefit. Please contact James Cross, Kingston Smith LLP, at jcross@kingstonsmith.co.uk

Do your annual report and statutory accounts make an impact?

Good governance is about being open and accountable for your actions and demonstrating the results of your work to your stakeholders. Most charities use their statutory accounts, and particularly the narrative of the trustee's report, as an opportunity to demonstrate their successes and even the odd failure.

Many charities have been grappling over the last year with how best to demonstrate public benefit in their accounts. The easiest aspects to describe are your outputs, i.e. the activities and services delivered. More difficult is the measurement of outcomes, i.e. the changes that your activities have brought about, and further still, how you demonstrate the impact you have made to society (the general public).

The Charity Commission and the Office of the Scottish Charity Regulator have together published 'Charity Report and Accounting: Taking Stock and Future Reform', the results of research undertaken by Queen's University Belfast, Management School, as part of an ongoing process of evaluation of SORP.

The findings of this research provide evidence that all charities, regardless of size, consider funders to be their key stakeholders. Funders are particularly interested in understanding achievements and how your charity has 'made a difference' in determining how their funding should be shared out, especially in the current economic climate. Recent research by Philanthropy UK indicates that donors are concerned about the effectiveness and efficiency with which charities use their money. Insufficient confidence in a charity can be a barrier to giving.

Considerations before undertaking impact assessment

From the outset it is important to be clear about why you want to undertake an



assessment and to identify who your assessment is aimed at. You also need to consider how you will gather data to assist your assessment and to recognise the assumptions that are made in carrying out the work.

Focus on your intended impact first and work backwards from this in order to set the boundaries and context within which assessment will be undertaken. Stick to measuring a few key indicators, making sure they link to planned outcomes/impact.

Set a time period over which the assessment will be made. A more complicated model that involves empirical research may take a long time from planning through to completion.

Identifying a causal relationship between an activity and an outcome/impact may be difficult, particularly if you are attempting to measure preventative activities. How do you know for example that with a drug prevention initiative it is your work that has prevented certain individuals from taking drugs?

By its nature, the use of baseline data against which to benchmark impact limits measurement to outcomes anticipated at the outset. Thorough and careful planning needs to be undertaken to ensure the measures are reliable and this will involve extra time, resources and cost.

Measuring and reporting impact

There are a number of models that can be used to demonstrate impact. The simplest include PQASSO, which demonstrates benchmark quality standards for smaller

entities, to more complex Social Return on Investment (SROI) models, which use a costing model to value the cost saving to society of outcomes (for example the net cost saving in judicial care and policing as a return for crime reduction initiatives).

Measurement of soft outcomes, such as increased well being and self confidence, will be subjective and so may be best measured through questionnaires and interviews with beneficiaries before and after receiving your charity's support.

Impact assessment works best when communicated through a combination of numbers (quantitative) and stories (qualitative) data. The charity should 'tell a story' in a way that delivers an impact that captures the target audience. Demonstrating a real benefit to the public is about changing lives and perceptions. Arguably this means taking a longer-term view of impact than is the current norm and extends to social and environmental impact reporting.

Whether such reporting will be expressly incorporated into the requirements of the next SORP remains to be seen, but there are certainly advantages to be gained from exploring new ways to measure and demonstrate impact and effectiveness and developing a model that suits your charity. A further benefit to the charity is an increased internal focus on whether resources are being used properly and costs managed well.

For further information please contact [Sandra De Lord, Kingston Smith LLP](mailto:sdelord@kingston-smith.co.uk), at sdelord@kingston-smith.co.uk

Why you don't understand your risks (and probably never will)

In general, humans are bad at judging risk. Sorry to be so negative, but it is true. There are several reasons why this is the case.

Complexity – Impressive though our brains are, even basic risks carry too many uncertainties to judge with precision. A simple example is a cash deposit in an advanced western bank safe? Consider historic default rates, quality of bank assets, systemwide leverage, legal recourse and government attitude (and resources) to providing guarantees. Apply these to, say, Iceland (or Ireland, or the UK) and come to a possibly very wrong and expensive answer. And that is a simple risk scenario.

Familiarity – Driving is a higher-risk activity than flying. Driving is familiar, flying less so, which is perhaps why more people fear flying over driving. In the same way, risks that we see everyday at work are underestimated. Take those familiar computer systems, the true scale to which they enable fraud, data theft and systematic error is rarely taken seriously until it happens.

Incentives – Bankers received big bonuses when high-risk gambles worked but they did not suffer big losses when they failed. It's the same asymmetric payout profile in the charity sector but in reverse. Trustees gain little from risks which deliver upside but lose a lot from failure (position and reputation), which creates a tendency to view any unfamiliar risk as unacceptable whatever the benefits.

Niceness – We like to think the best of people and that leads us to put our faith in the 'good' people who work for us, the 'honest' managers who lead them and the 'trustworthy' third parties we engage. This reliance on soft adjectives to limit risk rather than hard and tangible controls is strong in the charity sector, which tends to make the disappointment (and cost) of failure worse when it does happen.

More bad news – research suggests that when we work in committees, group dynamics render our judgement of risk even more inaccurate.

So why bother trying to manage risks when we are so imperfect? Because not trying is much worse. What really helps is committing to do the things which give the best chance of making your organisation resilient to shocks. We think you should focus on:

Perennial risks – These are the big risks you face now and will always face for as long as you operate. You do not need to assess and analyse them with precision; it is enough to know they are constant and big. These risks deserve long-term investment in systems to get them under control. Spending money doing this will payback in the long run.

Responding to all issues – With few exceptions, big issues start life as small issues that were given low priority. Every error, delivery issue or complaint should be looked at to identify its potential to get a lot worse. As we cannot foresee all risks, responding quickly to events is a vital survival mechanism. Staff should be trained to recognise 'red flags' early and escalate them fast.

Planning for cash shocks – Surviving bad risk judgements eventually comes down to having cash to overcome the mistake. Prepare for this by projecting a crisis cashflow scenario and having a plan on what will be done to survive. As cash runs out, options become radically fewer and banks much less co-operative. Identifying a cash crisis at an early stage and taking rapid action gives the best chance of survival.

...rely less on understanding your risk...and take more time taking actions that will reduce your exposure to risks...

Third parties you work with – Getting what you think you have contracted for is more likely to happen if you are looking. Madoff thrived on customer complacency. There are outsourced data centres with no disaster recovery capability and payroll processors with no IT security that are also doing pretty good business.

Our cautionary message is to rely less on understanding your risks (you will almost certainly be wrong, and may feel a false sense of security) and take more time taking actions that will reduce your exposure to risks, whatever they turn out to be.

If you feel your approach to managing risk needs sharpening up, please contact [David Morrey, Kingston Smith Consulting LLP](mailto:David.Morrey@kscllp.co.uk), at dmorrey@kscllp.co.uk



Donor loyalty... in a cold climate

Despite some retailers posting better-than-expected sales figures over Christmas, consumer confidence is still low. So reduced discretionary spend continues to restrict personal donations and means even greater competition for each donor pound.

But out of the doom and gloom there is some hot news – an approach that can address your own business imperatives and help maintain and even increase revenue levels.

The solution lies with maximising the use of your database and turning it into a powerful marketing tool. What you know about your donors and supporters can help drive more relevant communications, resulting in a better relationship and increased loyalty. The key to building your insight about donors and supporters lies in bringing together everything you know or could know about them.

Using your database goes far beyond the realms of pure direct marketing. A single view of donors and supporters can reveal who is a regular supporter, who is an ad hoc donor, who only ever attends events, and when and to which campaign they have responded. Perhaps you already understand the 'who', 'what', 'when' and 'how' that were behind the donors' actions.

But what if you were able to add the 'why' factor - the additional dimension that establishes true differential between casual supporters and committed givers. Why a donor remains loyal?

To achieve this you must also include a view of the attitudes and aspirations that drive their support decisions. Such insight into donors and supporters will:

- help pre-empt churn;
- show opportunities for cross-sell and up-sell;
- help you understand why specific propositions are successful with certain types of supporter or prospect;
- reveal preferences, such as which types of ad hoc supporters will never become committed givers or attend events;
- increase the effectiveness of prospecting.

The solution lies with maximising the use of your database and turning it into a powerful marketing tool.

You can achieve this through fusing analysis donor and supporter involvement across all of your charity's fundraising programmes and events with market research survey data to determine the true differentiators. The outcome can then be used to create communication strategies to ensure no opportunity is lost and the supporter is always directed towards the best next action, driving relevant, targeted communications.

Consider the scenario where information acquired through tracking response and behaviour is matched to the researched view of attitudes and aspirations to create supporter profiles. These can be used to determine how best to move the relationship forward or flag up potential danger signs. Does their most recent action (or inaction) indicate possible churn? Has their most recent donation been exceptionally different to all those before? Are they approaching a major milestone in their relationship with the charity, such as coming up to their third anniversary as a committed giver which has traditionally been a jump-off point for donors like them?

Having insight in to what motivates them to behave the way that they do can be used to generate a relevant communication or even direct that supporter to the right web page or telephone agent as part of a strategy to retain their donation or cross-sell into a new area of support.

What you can determine about current donors and supporters can also be applied to prospecting activities in a similar way, to help meet acquisition goals. You can access this analysis and profile-building service as part of the range of services Kingston Smith provides to the not for profit sector.

Specialist consultants and analysts will help you extract the necessary data from your in-house systems and direct a subtle yet effective combination of database strategy, analytics and survey activity that delivers segmentation and profiling.

They will apply data-mining techniques to identify the latent trends, opportunities and threats. The results identify the different donor profile attributes influencing donations, and support and provide direction on favoured channels and extent of communication and preferred promotional activity. Armed with this knowledge you can ensure your marketing strategy addresses these issues to drive the relationships.

To find out more about gaining the competitive edge in today's economic climate, please contact [Jane Hellings, Kingston Smith LLP, at jhellings@kingstonsmith.co.uk](mailto:jhellings@kingstonsmith.co.uk)



Seminars and courses

Seminars

16 March – Luton

75-minute guide to accounts for non-accountants

13 April – Brentwood

Gift Aid – Maximising the returns and avoiding the pitfalls

25 May – Heathrow

Gift Aid – Maximising the returns and avoiding the pitfalls

9 June – City

Is your data really as safe as you think? Probably Not!!!

Schools

23 March – Dorking

How can schools meet the public benefit requirements?

28 April – City

Managing your finances in the current economic environment

Courses

The Fundraising and Management Division delivers a range of training courses targeted at the not for profit sector. We aim to build on our highly successful seminar programme by offering training courses, designed to provide a more in-depth analysis of topics that are relevant to the sector. Delivered by our in-house team of experts, we will tackle current issues using up-to-date best practice. These training courses will be suitable for trustees, CEOs and directors of fundraising.

Governance – An overview of trustee duties

2 March – City

11 May – City

Membership: Donor development and retention

22 April – City

Fairytale fundraising strategies

26 March – City

22 June – City

How to book?

Kingston Smith runs an extensive programme of seminars. To access the full programme and book your place visit www.kingstonsmith.co.uk/events or email events@kingstonsmith.co.uk or phone 020 7566 3850

Contact us

More information about Kingston Smith LLP and our services can be found at www.kingstonsmith.co.uk

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