

# Charity News

Autumn/Winter edition 2009

## Mergers: the beginning of a beautiful partnership?

Over the last twelve months there has been an increasing amount of coverage in the press about mergers between charities. This coverage has focused on the opportunities for charities to increase their impact by merging with one or more partner organisations. But is it something your organisation should be considering and if so what does it mean in real terms?



**Carol Rudge**  
Head of Charities and Not-for-Profit

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Although the route to completing a successful merger will vary from one organisation to the next there are some common steps, as set out below, which should be considered by all.

#### Step 1: Define the parameters

The first step in a merger process is to define the parameters in which you and your organisation are comfortable working. This will include:

- Setting your objectives – what does your organisation want from the partnership?
- What are the “must haves” or non-negotiables for your organisation. This could include a whole range of

issues and objectives both financial and non-financial. All mergers involve an element of compromise – deciding upfront what you will not compromise on can save a lot of the heartache later on.

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## Mergers: the beginning of a beautiful relationship?

continued

- You will need to consider the costs. While there may be obvious financial consequences of pursuing a merger there are also other sacrifices relating to organisational identity and culture. These may be harder to quantify but will probably be just as hard, if not harder, to swallow, than financial costs.

### Step 2: Find a partner

Finding the right cultural fit can be one of the hardest parts of the merger process and as a result will probably take up a significant amount of time and energy. Your list of must haves will be critical in helping decide this. Some organisations may have one obvious partner, others will have to put together a list of potential partners and conduct preliminary due diligence on all of them before whittling them down to a short list.

Once you have found your ideal partner (or short list of partners) you will need to open a dialogue with them and begin to explore their aptitude towards a merger and what, in their view, a merger might look like. Any approach, which should at this stage be confidential, must be at the appropriate level and it may be some time before discussions reach a conclusion.

### Step 3: Obtaining stakeholder buy in

This is often the hardest part of the merger process and will require tact and diplomacy to ensure that all the critical stakeholders, whoever they may be, have bought into the idea of a merger and more importantly understand what the post completion organisation will look like.

### Step 4: Conduct due diligence

Regardless of who you identify as the ideal partner, prior to the merger you should consider carrying out cultural, financial and legal due diligence to

ensure that any issues are identified and dealt with effectively prior to the merger. This process will also form the bedrock of any post merger integration plan.

### Step 5: Realise the benefits – prepare a 100 day plan

Although the process up to this point may have been hard work, and possibly quite stressful, it is only once the merger has been completed that you and your partner organisation can begin the hard work that is needed to reap the benefits of the merger you have created.

While both parties will have given some thought to the benefits the merger will bring and how they can be realised, they may not have thought through the detail of what is actually involved, i.e. the quantifiable benefits in cultural and financial terms, the actions that are needed to realise them, the cost, and the timescales. All of these things must be considered and pulled together into a comprehensive plan covering the first few months of the combined entity's life.

It is important to remember that every merger is different and will have its own unique issues that will need to be overcome. As a result, we recommend that if you are thinking about a merger you should seek appropriate advice at the earliest possible opportunity.



Peter Dawson is a partner in Transaction Services and is leading on Grant Thornton's new Merger Broking Service. To find out more contact 020 7728 3197.

# Governance it's a good time

There is a tendency to focus exclusively on finances in difficult times, but there's actually no better time to bring an organisation's strategy under the microscope.

In other words, while attention to the financial health of an organisation is always uppermost in the minds of the Board, it is important for the core strategy to be reviewed and possibly refreshed. By undertaking a review of your core strategy at this time, you will be in a better position to offer pragmatic and future-focused advice when an upturn in the economy arrives.

During better economic times when budgets are more flexible, most organisations can put their hands up to a bit of 'mission creep'. Riskier decisions seem less so when the financial belt is looser. In a review of your operation from a governance perspective, you are likely to find deviations from your core mission which are using key resources, such as time and money, and contributing very little to your vision, your operations or indeed, your bottom line.

One of the quickest ways to discover whether mission creep has affected your organisation is to ask the Executive to report (with confidence,) on whether the activities they are currently undertaking can be measured to benefit those with whom they engage and whether there is any return above the cost of capital investment, taking into account the risks associated with the strategy?

# Success in difficult times: How to correct the flaws in your ~~strategy~~ strategy

Here is an example in a large charity where we worked with the Executive on just such an exercise:

- The charity discovered that over the past year colleagues had attended numerous face-to-face events, but they were unable to detail how much they spent, what happened as a result of their attendance and what benefits were delivered to their important beneficiary base.
- The same charity spent a substantial amount on recruitment advertising in a year where there was a recruitment freeze.
- The charity also realised that a 'pilot' project had continued employing people whilst the results of the pilot hadn't been analysed, resulting in a new department being built around a 'possible' new business line without Executive agreement.

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While we could focus on other anecdotes it is better to look at how to leverage the opportunities presented by the current environment.

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The following therefore highlights some positive ideas to make the most of the current situation.

First, in difficult times, it is critically important for the Board to be united, to speak with one voice and to govern as a body, not as individuals. The Board must always provide focused leadership for the organisation. This is certainly a primary responsibility, but here are some areas to think about that along with a fresh and critical review of your strategy, should place your organisation in a position to be focused, prudent and ready for the future:

1. Staff are likely to be feeling unsettled, and although a Board's relationship is primarily with the Chief Executive, it is important that the staff: understand the organisation's challenges; are engaged in meeting those challenges; and feel valued at a time when they are likely to be asked to do more with less. The Board should get assurances in this area.
2. The need to continue to cultivate relationships is paramount to help to keep your organisation on a secure footing in key areas. Ensure you let all of your stakeholders know that you are acting responsibly in these difficult times.
3. It is important to resist micro-managing, stick to your role and do a good job at your governance work, give the staff employed by the organisation the freedom to operate to their capabilities.
4. Refresh Board leadership skills – it is critically important for the Board to know how to deal with everything including a crisis due to funding shortfalls; the abrupt departure of a chief executive, poor results of a major audit; significant grievances; or compliance issues. Is your Board really ready for any of these challenges?

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Remember, most of an economic downturn can be viewed as an uncontrollable risk, which by definition means they cannot be directly controlled by your organisation.

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However, they can normally be predicted and, in many cases, they can be indirectly mitigated by modifying your strategy and managing the risks you can control.

The process for taking back control in an uncontrollable environment is simple:

- Review your core strategy and get assurances from the Executive that activities undertaken can be identified, evaluated and make a real contribution to the organisation and its stakeholders.
- Investigate 'mission creep' and reduce the risk.
- Get assurances that the staff understand what they need to do.
- Keep cultivating those relationships – they will be important for the future.
- Resist the impulse to micro-manage.
- Refresh your Board Leadership skills.



Sandra Malone  
Director

# VAT round up

New penalty regime implemented from 1 April 2009

On 1 April 2009 HMRC introduced a new penalty regime, on the basis laid out within the following table.

Where an error is identified it will be important to consider the behaviour that led to the problem. If the error occurred despite reasonable care the penalties are not relevant, but in any other case disclosure should be made to ensure mitigation is available.

Where HMRC believe that the taxpayer has made a mistake but has taken 'reasonable care', no penalty will be charged. HMRC may reduce a penalty based on whether the disclosure is 'prompted (PD)' or 'unprompted' (UPD), and based on its 'quality' (ie its timing, nature and scope).

Currently the voluntary disclosure and new penalty regimes conflict as all errors are potentially subject to penalty. Therefore adjusting through the VAT return will not 'count' as an unprompted disclosure. Until this anomaly is acknowledged by HMRC we recommend all errors are notified and brought to the attention of HMRC.

## Changes being introduced in 2010

From 1 January 2010, the standard rate of VAT will revert to 17.5%.

From 1 July 2010, the 10% concession on charitable buildings will be withdrawn. Charities will have to certify that any building constructed/acquired qualifies for zero-rating because it is to be used 'solely' for relevant charitable purposes. 'Solely' is now defined as at least 95% use (ie a reduction from 90% under the concession). The calculation of the percentage, however, is less prescriptive.

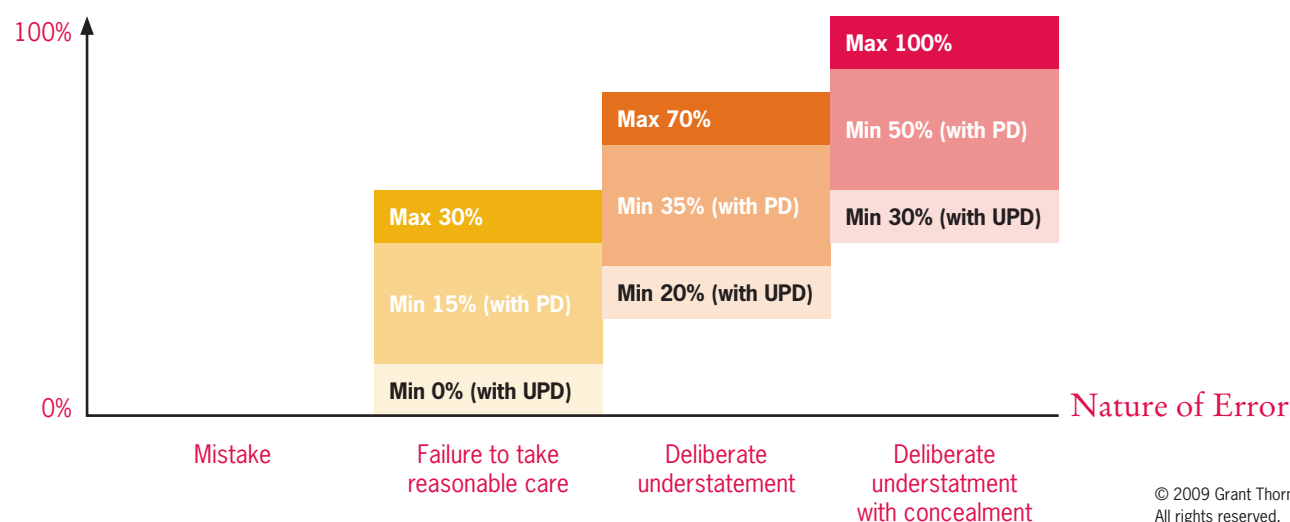
HMRC has also introduced anti-forestalling legislation where connected suppliers and customers manipulate the time of supply rules to take advantage of the lower rate of VAT before 1 January 2010 and the buyer cannot recover all of its VAT. These circumstances produce a supplementary charge of 2.5% which will be due on 1 January 2010.

## VAT Package – Reverse Charges on Supplies received for non-business purposes

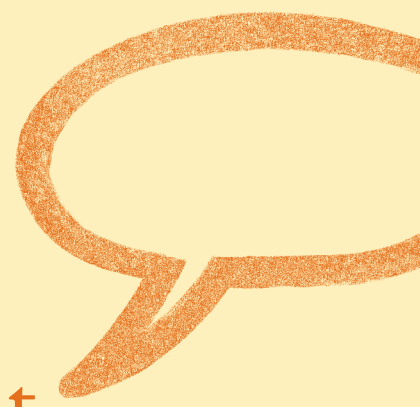
From 1 January 2010, most supplies to VAT registered customers engaged in business and non-business activities will be subject to the reverse charge. This means, for example, that a UK charity engaged in both business and non-business activities will be required to charge itself VAT on all services brought in from overseas (unless they would qualify for exemption), even if they relate solely to its non-business activities.

VAT will usually be due at the UK standard-rate, ending the opportunity to 'rate shop'. Some exceptions, e.g. for services relating to land, will remain outside the scope of UK VAT.

## Penalty Level



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# A word about salary sacrifice – or exchange!

## The Garsington Opera Case and ‘Sufficient Link’

This is a recent case which has led to a re-evaluation of the concept of a ‘direct and immediate link’ between input tax and taxable supplies and thus provides hope for further recovery by charities.

Following the 2007 Mayflower case, recovery of VAT incurred may be possible on purchases that are used mainly for exempt supplies but which are also ‘connected’ to certain taxable outputs. In the case of Garsington, it was argued that production costs that were linked to taxable sponsorship income as well as exempt ticket sales may be recoverable in part.

This could serve to widen the scope of input VAT recovery on purchases that have a direct and immediate link to the making of taxable supplies.

## VAT on text donations

The Mobile Data Association (MDA) has announced that VAT will not be charged on charitable donations made by text to dedicated mobile short codes.

While the VAT exemption relating to fundraising events by charities always existed, it would appear that, previously, there was no way of identifying the messages to which the exemption ought to be applied.

Now, eligible charities will receive an estimated 10p in the £1 extra for text gifts of up to £10. Any five-digit SMS text message short code beginning with the number 70 is now automatically considered to be a charity code.

The framework has been approved by the UK’s mobile network operators, 3, Orange, T-Mobile, Telefónica O2 and Vodafone.

**Sally McKinlay**  
Senior VAT Manager

The term ‘salary sacrifice’ is becoming unpopular with employers and employees. Asking an already beleaguered employee to sacrifice pay in these straitened times can be unwelcome, unless the concept is fully explained at the outset. ‘Salary exchange’ is being increasingly used and actually reflects the reality of the situation somewhat better.

But for the purposes of this article, the more familiar term will be used. Salary sacrifice is a legal device by which an employer and an employee mutually agree to vary the way that reward is delivered, so that the employee takes a smaller cash salary and a benefit, rather than a larger cash salary. Because it is an irrevocable legal process it is critical that a salary sacrifice is entered into in the proper form and that it has been set up before the right to receive the new pay structure becomes effective. Though this sounds complicated, what it means in practice is that, if the new pay deal is to start on January 1st, the salary sacrifice needs to be signed, sealed and delivered by December 31st. The word ‘irrevocable’ can be frightening, but effectively most salaries are awarded on an annual basis and so at the next pay review things can be revisited.

An additional chance to reset the clock may happen in year, if the employee has a ‘lifestyle’ event. This is not legally determined but

generally means something which changes and affects all areas of life, such as marriage or civil partnership (or the dissolution of either), the birth of a child etc. Whilst there is no legal requirement for an employer to seek HMRC approval, and indeed HMRC have said that it is not within their remit to comment on the composition of a salary sacrifice, only on its effect of the taxation of its various elements, at Grant Thornton we generally recommend that employers bring their scheme to HMRC’s attention at the outset.

Will a future administration attack the concept of salary sacrifice? Again, that will remain to be seen. At present, though in my experience HMRC are somewhat suspicious of salary sacrifice, essentially the way that a benefit is delivered should not affect its treatment for tax and National Insurance purposes.

**Ellie Gamble**  
Senior Manager

# Do I really have to be green?

I embrace sustainability, care for the environment, climate change, carbon footprints and the rest. So my short answer is – “YES”.

But what is the evidence and where is the motivation? The experts provide much convincing material to support criticism of our habits but some eminent voices disagree. I don't trust them all but have developed some personal convictions.

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I believe the increasing world population is degrading the environment, whether by pollution, deforestation or simply using resources quicker than they can be replaced, for example over-fishing.

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What is the effect of this behaviour? We see famine, flood, poor health and much else; although not necessarily caused by our behaviour, it is clear to me that our activity is not helping and will make matters worse. I do not trust all the forecasts but am convinced there is enough to worry about. As a member of the House of Commons Audit Committee, disruption to the work of the House through an environmental event, such as flooding, features as one of the main corporate risks. And I fear that this may become an increasing problem for many charitable beneficiaries and the next generations – so many charities deliver services in the areas of health, poverty and famine that it is close to the heart of our sector.

So, whose problem is it? Of course, it is one for all of 'us', not 'them'. It has to be tackled by us as individuals on behalf of our families and communities, as trustees, volunteers and staff of charities and as professionals able to influence others.

Many of us are in leadership roles and therefore have a greater responsibility.

What can we do? Many charities already work in the areas of sustainability and related activities – we can support them. It is really important not to re-invent the wheel and so we should take what we can from the leadership given by charities and other organisations active in this area. Contact them if you want to know what you can do. Adopt their guidelines and start with the easy bits.

How about some compulsion? The government tries to use both carrot and stick – from wheelie bins to light bulbs, but we should not wait for the charity sector to emulate the private and public sector.

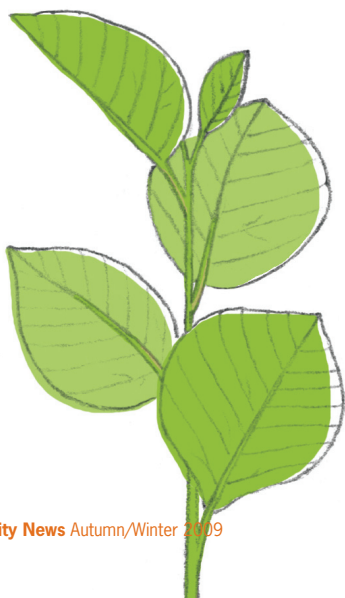
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I do not yet see SORP compelling an environmental report in the way that is emerging elsewhere, but if a charity is taking effective positive steps, it should surely be proud of this and tell the world.

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This is part of leadership and peer pressure. In the spirit of transparency and accountability, I urge you to take inspiration from the CFDG's recent publication Sustainability in Practice: monitoring and reporting – this gives you 'everything you wanted to know'.

Another current initiative is the Ministerial Task Force for the Third Sector and Climate Change, the Environment and Sustainable Development, with NCVO heavily involved. The Task Force is hoping to identify practical actions that we can take in response to the threat within our own



# Breaking Ground

Through a combination of integrated transactional expertise and our in-depth experience in the not-for-profit and health care sectors, Grant Thornton successfully advised on the first not-for-profit organisation, Housing 21, to takeover a publicly quoted company, Claimar Care Group.

Stephen Baker, Corporate Finance Partner, who led the team, commented: "As far as we can establish this is the first time that a not-for-profit organisation has launched a full takeover of a publicly quoted company in the UK. The transaction posed the unique challenge of balancing the objectives and philosophies of a social enterprise with the requirements of a corporate transaction under the Takeover Code. Ultimately, though, this is a great opportunity for Housing 21 to take a significant step forward in their strategic plan so our job was to make it happen for them."

Stephen continued: "Bringing in-depth knowledge about our client's business and that of the target enabled us to assist Housing 21 in determining a fair offer price while ensuring our client was comfortable with the strategic fit and the quality of the business that they are buying."

organisations, with government and in communities.

The aim is to scale up action and commitment on climate change by third sector organisations.

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The starting point is that climate change is about people and therefore is relevant to every sector/organisation. It is important to our sector because of the impact on beneficiaries and because of our wider role within civil society, as a catalyst for collective action and a voice for change.

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What are the barriers to doing something? The economic downturn has made organisations nervous about 'green' expenditure. But taking action can be inspired by cost-saving. So, start with these and then move on. Turning off lights and computers and using less water seems old hat, but are still not universally adopted.

What is the Charity Commission's attitude? In their Going Green: Charities and Environmental Responsibility, the Commission suggests measures charities can take to improve the environmental impact of their premises both those which may result in cost savings, and those which might involve a substantial cost – such as fitting solar panels. I quote: "Charities are allowed to spend their money in this way provided the trustees are satisfied that it is reasonable to do so and will enable them to achieve their charitable purposes effectively having considered the relevant factors.

Where these measures will reduce costs for a charity, for example, shutting PCs off at the end of the day the charity will be maximising the use of their resources, which they are required to do in any event. Where a cost is involved, it is reasonable for trustees to do this where they have balanced the additional cost of environmental measures against

other factors such as benefits to their reputation and donor confidence."

You may wonder why I have the nerve to preach like this. My five years with WWF-UK, with six months as acting CEO, is part of the answer.

I wish you a small carbon footprint and a large green one!



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**David Taylor**  
Charities Consultant  
Charities and Not-for-Profit Group

Our programme of seminars continues for 2009. If you would like to attend any of the seminars or receive any additional information, please contact **Louise Truswell** on **020 7728 2695** or [louise.truswell@gtuk.com](mailto:louise.truswell@gtuk.com)

<b>Date</b>	<b>Location</b>	<b>Seminar</b>
<b>Wednesday 20 October</b>	<b>London</b>	<b>Mergers</b>
<b>Wednesday 4 November</b>	<b>London</b>	<b>Tax/VAT/PAYE update</b>
<b>Tuesday 8 December</b>	<b>London</b>	<b>Topical update</b>

## Venues

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If you would like to find out more about how Grant Thornton can assist you, please contact one of our Charity and Not-for-Profit specialist partners listed on the right. Alternatively, visit our website at [www.grant-thornton.co.uk](http://www.grant-thornton.co.uk) or contact **Carol Rudge**, Head of Charities and Not-for-Profit, directly on **020 7383 5100**.

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