



Asset transfer schemes and restricted funds reorganisation

22 February 2012

INTRODUCTION AND KEY POINTS

Introduction

1. The Charities Committee of The Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the Scottish Government's proposals for:
 - The Charities (Scheme for Transfer of Assets) (Scotland) Regulations; and
 - The Restricted Funds Reorganisation (Scotland) Regulations
2. The ICAS charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key points

3. The Charities and Trustee Investment (Scotland) Act 2005 aims to protect charitable assets whether these are held by a registered Scottish charity or another organisation. We fully support the establishment of robust arrangements for the protection of charitable assets in the interests of those who benefit from those assets. However, we believe that the proposals for asset transfer schemes are fundamentally flawed, putting at risk an organisation's stakeholders, including its beneficiaries and creditors. By removing assets from an organisation, an organisation could become financially stressed to a point where it cannot pay its debts and where suppliers, donors and providers of finance would not have sufficient confidence to do business with it. A parallel in the commercial sector would be the creation of a situation where the directors of a company could be wrongfully trading. There is a risk that OSCR could be exposed to legal action by an organisation's creditors or providers of finance, if it places an organisation in financial stress or into insolvency through an asset transfer scheme.
4. We recognise that the number of organisations which are likely to be subject to an asset transfer scheme is very small. Therefore, we recommend that the judicial factor route is used on those occasions OSCR believes it necessary to remove an organisation's assets from the control of its governing body. This is a tried and tested approach which would protect charitable assets while limiting the impact on an organisation's stakeholders.
5. There are a number of fundamental questions which should be considered by the Scottish Government before transfer schemes become available:
 - What steps will OSCR take to ensure that a draft scheme will not make a transferring organisation insolvent, trigger, or otherwise result in additional liabilities such as pension liabilities or redundancy payments, for a transferring organisation?
 - How will the creditors of a transferring organisation be protected in the event that a scheme is approved?
 - Will OSCR be obliged, perhaps with recourse to the Court of Session, to take steps to prevent an organisation disposing of property or other assets within the scope of a draft or approved scheme before the date of transfer to the recipient charity?
 - How will any beneficiaries of these organisations be protected in the event that a scheme transfer is approved?
 - Can an asset purchased with a grant, where the proceeds should be returned to the donor on disposal, be included within a scheme?
 - What steps will OSCR take to ensure that a transferring organisation which is a company is not at risk of wrongful trading as a consequence of a scheme?
 - How will OSCR ensure that a draft scheme does not cause a transferring organisation to breach any bank or loan covenants?
 - How will OSCR ensure that a draft scheme does not place an organisation in a position where it may not be able to meet its ongoing commitments, such as staff salaries?
 - Will OSCR be able to include assets which are subject to floating or fixed charges within a draft scheme?

- Under draft schemes how will the following be treated: goods sold under reservation of title; goods supplied under higher purchase type arrangements?
 - How will OSCR ensure any tax liabilities arising from deemed disposals, where a transferring organisation has lost its charitable status, can still be met by that organisation?
 - How will OSCR ensure that a scheme does not inadvertently place liabilities on the recipient charity?
 - How will OSCR ensure that a draft scheme does not increase the personal liability of the trustees, directors, governing body members or equivalent of a transferring organisation for the liabilities, including debts, of that organisation?
 - Will a body which is subject to an approved scheme have any right of appeal?
6. We support the proposed regulations for reorganisations of restricted funds, with some proposed refinements which we recommend in our response to the consultation questions.
7. Our comments on the consultation questions are included in the following sections of our submission.

COMMENTS ON ASSET TRANSFER SCHEME REGULATIONS

Question 1

Are there any steps OSCR should be required to take before deciding whether to apply for approval of the scheme? If so, what other steps should be included?

Response

We believe that while the judicial factor route may be more expensive than an asset transfer scheme, it is a well established route which would protect charitable assets without creating undesirable unintended consequences.

Should the Scottish Government proceed with the implementation of the asset transfer scheme regulations, we believe that OSCR would need to undertake a due diligence type exercise which:

- should include determining whether an asset transfer scheme is the most appropriate course of action in the circumstances; and
- addresses as a minimum all the questions we raise above about the potential impact of the draft asset schemes on identified stakeholders.

Unless this approach is taken, we do not believe that OSCR could assess any scheme as reasonable. However, we believe that it would be preferable for any asset transfer scheme regulations themselves to address our concerns and any additional key concerns raised by other commentators.

Question 2

Does regulation 4 capture all the information that should be included in the draft scheme? If not, what further information should be included?

Response

We believe that the following further information should be included in regulation 4:

- A statement of the liabilities which are to be transferred;
- Specification of the date on which the liabilities are to be transferred; and
- An extension of the statement about reasonableness setting out why an asset transfer scheme is the most appropriate means of protecting charitable assets, specific justification of the draft scheme proposed and details of the scope and results of the due diligence exercise which has been undertaken.

Regulation 13(f) refers to a statement which shows a charity's incoming resources and resources expended for the preceding financial year. However, charities which prepare receipts and payments accounts do not record incoming resources and resources expended in their accounts. Therefore, we believe that the regulations should also be tailored to meet the needs of charities preparing receipts and payments accounts.

Question 3

Does regulation 4 require too much information to be included in the draft scheme? If so, what information should not be required?

Response

We do not believe that too much information is required to be included in the draft scheme and there are no information requirements we believe should be deleted.

Question 4

Do you agree that OSCR should be required to publicise the draft scheme it prepares prior to applying to the Court?

Response

We believe that OSCR should be required to publicise a draft scheme and that OSCR should have a duty to contact directly key stakeholders identified during the due diligence exercise with a copy of the draft scheme and details of how to make representations. For example, there must be greater protection for creditors and OSCR should have to contact in writing all major creditors of the transferring body, including any public bodies, giving them 28 days to make representations.

We also believe that any organisation which is subject to a draft scheme and which has a website should be required to publicise the draft scheme on its website.

Question 5

Do you agree with the income threshold for placing a notice in the newspaper?

Response

We are not convinced that placing a notice in a newspaper or placing details on the OSCR website, will be sufficient to alert an organisation's stakeholders to the draft scheme and we believe that it would be more effective and more appropriate for OSCR to contact key stakeholders identified during the due diligence exercise directly. We believe that this should apply to all organisations subject to a draft scheme, regardless of size.

With regard to the threshold for placing an advert in a newspaper, we are not convinced that £250,000 of gross annual income of an organisation's restricted funds is the correct measure on its own. We believe that the threshold should also include a balance sheet test (i.e. a restricted funds gross assets test) and a restricted funds creditors test and we would prefer a lower income threshold, perhaps £150,000.

The reason for suggesting the introduction of a gross assets test is that an organisation's income can vary widely between financial years, for example, due to legacy income. An income test plus a gross assets and a creditors test would give a better indication of the scale of the organisation. Some charities prepare receipts and payments accounts which include a statement of assets and liabilities rather than a balance sheet. Therefore, further consideration is needed on how best to specify a gross assets test and a creditors test within the regulations for charities which prepare receipts and payments accounts.

Further clarification is required around the term 'gross income' on two grounds:

- Firstly charities, which prepare receipts and payments accounts, record receipts rather than gross income; and
- Secondly for a charity, which prepares a Statement of Financial Activities (SoFA), identifying its 'gross income' in restricted funds is not straightforward. A charity is required to record 'incoming resources' not 'income' in its SoFA. 'Incoming resources' include funding for capital projects which would not be recorded in an income and expenditure account. Therefore, we recommend that the threshold is specified with reference to 'incoming resources' in restricted funds for charities preparing a SoFA to avoid OSCR having to interpret the law.

The regulations should also refer to the reporting period to which the threshold is to apply. We recommend that the threshold should relate to the latest set of accounts which have been filed with OSCR, or which have been approved by an organisation's governing body. There is the potential for the existence of a draft scheme to impact on an organisation's relationship with its funders, lenders and suppliers, which could result in an organisation which would normally meet the threshold for a newspaper advert to fall below that threshold.

Question 6

In the case of a body which is not a charity, should the newspaper notice always have to be placed in a national newspaper? If not, what criteria should be applied when deciding on publicity requirements?

Response

We believe that as consistent an approach as possible to newspaper notices should be followed for any type of body which is subject to a draft scheme. However, organisations which are charities are likely to use different accounts format, for example, an Income and Expenditure Account rather than a SoFA may be prepared. Therefore, the income related threshold for other organisations would need to refer to 'gross income' rather than 'incoming resources' or 'receipts'.

Also see our comments on questions 4 and 5 about contacting key stakeholders.

Question 7

Do you agree that the regulations should allow for representations rather than objections?

Response

We do not have a strong view on this but are content with the reference being to representations rather than objections.

The regulations do not refer to any mechanism for raising objections or lodging an appeal with the Court of Session or higher court, we envisage that these would form elements of the procedures in place around an asset transfer scheme. Therefore, we recommend that any guidance issued by OSCR or the Scottish Government on asset transfer schemes refers to objections or appeals beyond the arrangements for making representations to OSCR. We also believe it would be necessary to set out in guidance any recourse available to creditors. For example, a judicial factor is required to recognise a secured creditor, what protection would a secured creditor of a charity or another organisation have under an agreed asset transfer scheme?

Question 8

Should the regulations specify how OSCR handle representations? If so, how should the regulations require OSCR to handle them?

Response

Even though asset transfer schemes are proposed by OSCR and reorganisation schemes for restricted funds are proposed by the charity, we believe that procedures for handling representations should be consistent. Therefore, we believe that the requirements proposed for the reorganisation of restricted funds should also apply to asset transfer schemes. This includes providing organisations, which are subject to a draft scheme, copies of representations, which should not be on an anonymous basis.

Question 9

Does 14 days between the deadline for receipt of a representation provide OSCR sufficient time to consider its decision?

Response

This will depend on the nature of the representation and the workload of OSCR staff assigned to deal with representations. However, 14 days may be insufficient time to adequately deal with representations containing objections or suggested improvements. We believe that 28 days is a more realistic timescale. It is essential that OSCR has sufficient time to consider objections or suggested improvements to ensure the scheme is robust otherwise there is greater potential for a flawed scheme to be submitted to the Court of Session.

Question 10

Should OSCR be required to give anyone else notice of its decision whether or not it intends to proceed with its application to the Court of Session? If so, who else should they notify?

Response

In addition, we believe that OSCR should publish its decision on its website, contact any key stakeholders who may have been contacted as part of the due diligence exercise, which we recommend is undertaken, and contact anyone who made a representation. Also, if the transferring organisation has a website the outcome of OSCR's decision should be published on its website too.

COMMENTS ON RESTRICTED FUNDS REORGANISATION REGULATIONS**Question 11**

Does the above list cover all the information which a charity should have to provide to OSCR? Should any information not be included? Or should further information be included?

Response

We broadly agree with the list of information set out in regulation 13. However, we believe that references to property in regulation 13(a) should be replaced with references to the assets and liabilities of the restricted fund. This would be consistent with the reference in regulation 14(3)(a) to assets and liabilities and would be a more accurate description of the elements which make up a restricted fund.

We would also support a further requirement for charities to provide a detailed breakdown of the classes of assets held within the restricted funds, for example, a restricted fund could include heritable property, investments, debtors and cash.

Prior to the 2005 Act, charities were able to reorganise restricted funds of less than £5,000 without the permission of the Court of Session. Therefore, we would welcome the inclusion of a specific duty on OSCR to be mindful of the scale of the proposed reorganisation scheme in seeking information from the charity.

Question 12

Do you agree with the requirement to place a notice on OSCR's website in every case?

Response

We support the requirement for a notice to be placed on OSCR's website in every case and, where the charity has a website, for the proposed reorganisation scheme to be published on the website.

Question 13

Do you agree with the requirement to place a notice in an appropriate newspaper if the income of the restricted fund is over £250,000?

Response

We would support a lower threshold, perhaps a threshold of £150,000, plus the inclusion of a restricted funds asset test. The threshold should be further refined to refer to incoming resources rather than gross income and to refer to receipts, for charities which prepare receipts and payments accounts.

We are not convinced that placing a notice in a newspaper or placing details on the OSCR website, will necessarily alert a charity's stakeholders or stakeholders of the restricted fund (for example, a previously missing donor) to an application to reorganise restricted funds. Therefore, we also recommend, as referred to in our response to question 12, that charities which have a website are also required to provide details of a proposed reorganisation scheme on their website.

We recognise, with the aim of reorganisation schemes being to release funds for charitable purposes, that the likelihood that stakeholders will be adversely affected by a proposed scheme is minimal and therefore publicity for the proposals is less critical than the level required for an assets transfer scheme.

Question 14

Do you agree with the requirement to specify the wording for the newspaper advertisement? Should this requirement be introduced for the Charities Reorganisation (Scotland) Regulations 2007?

Response

We are content with the wording for the newspaper advertisement to be included within the Charities Reorganisation (Scotland) Regulations 2007.

Question 15

Do you agree that the regulations should allow for representations rather than objections? Should this change be introduced for the Charities Reorganisation (Scotland) Regulations 2007?

Response

We do not have a strong view on this but are content with the reference being to representations rather than objections.

Question 16

Should the regulations specify how OSCR handle representations? If so, how should the regulations require OSCR to handle them?

Response

We believe that OSCR should provide the charity with copies of all representations received within seven days of the deadline for making representations and that representations should not be anonymous. We also believe that anyone who makes a representation should be made aware of OSCR's approval or otherwise of a proposed reorganisation.

Regulation 7 gives OSCR six months from the deadline for making a representation to make a decision on an application. We believe that six months is far too long and would represent a significant delay in enabling funds to be applied for charitable purposes. We believe that two months would be acceptable.

Other comments

In Regulation 12 we believe that the definition of a donor should be extended to (2)(b) as follows: who gave **or bequeathed** the restricted funds to the charity. This is to reflect the fact that charities can receive restricted legacies.