NAO
NATIONAL AUDIT OFFICE

Report by the
Comptroller and Auditor General

Charitable funds associated with NHS bodies

HC 516 Session 1999-2000
15 June 2000

Report by the
Comptroller and Auditor General

Charitable funds associated with NHS bodies

Ordered by the
House of Commons
to be printed 12 June 2000

LONDON: The Stationery Office
£0.00

HC 516 Session 1999–2000
Published 15 June 2000

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn
Comptroller and Auditor General

National Audit Office
16 May 2000

The Comptroller and Auditor General is the head of the National Audit Office employing some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

email:nao@gtnet.gov.uk

Web site address: www.nao.gov.uk

Contents

Executive summary

Introduction

1 There are over 500 trustee bodies administering charitable funds associated with the National Health Service that hold net assets amounting to some £1.8 billion. Trustees are responsible for the administration of the individual charities and for ensuring that assets are properly managed, controlled and safeguarded in accordance with trust and charity law. Trustees may be bodies of s*pecial trustees* responsible for controlling funds held historically by many teaching and university hospitals, or *corporate trustees* where the board of an NHS body, for example an NHS Trust, acts collectively as a trustee for associated charitable funds.

2 From 1996-97 to 1998-99, the value of net assets held by the charities increased in real terms by some £220 million or 15 per cent. In 1998-99 income amounted to £314 million, mainly from donations of £159 million and investment income of £79 million. In the same year the charities spent £322 million on a wide range of projects to support the NHS.

3 All trustees are required to submit audited annual accounts to the Secretary of State for Health. Trustees of larger charities are also required to submit audited annual accounts to the Charity Commission. Under Section 98 of the National Health Service Act 1977 the Secretary of State is required to prepare annually a Summarised Account of the Funds Held on Trust. This account provides an aggregated summary of the assets, liabilities and activities during the financial year of the charities associated with the NHS.

4 The 1977 Act also provides for the Summarised Account to be audited by the Comptroller and Auditor General and presented to Parliament, and for him to have access to the accounts of trustees and the records relating to them.

5 Under the Charities Act 1993, the Charity Commission administers a general regulatory framework for charities in England and Wales. This includes the maintenance of a register of charities and oversight of the submission of annual returns and accounts in accordance with the 1993 legislation. Other regulators are responsible for specific elements of some particular classes of charity.

6 The specific responsibilities of the Charity Commission and the Secretary of State for Health for charities associated with the NHS are described in Appendix 2.

The National Audit Office investigation

7 This report sets out the results of examinations we undertook of the corporate governance and financial control arrangements at a sample of 21 of the larger trustee bodies, and our findings and conclusions on the arrangements for supervision and accountability of charitable funds associated with the NHS. The details of our study methodology are set out in Appendix 4.

Corporate Governance

8 Trustees are responsible for ensuring that a charity operates high standards in the management of its resources and in the delivery of its charitable aims, in accordance with certain legal and regulatory requirements and the expectations of the public. To this end, corporate governance provides a framework that enables trustees to direct and control their charities, including the setting of financial policy and overseeing its implementation.

9 We considered the arrangements that trustees have set up to secure high standards of corporate governance, against three key principles of integrity, accountability and openness. Overall we found that the charities we visited had made substantial progress in adopting these principles, often in line with guidance issued for exchequer funding within the NHS.

10 We identified many examples of good practice, covering a range of activities, where:

- ✓ the charities were run by a clearly identifiable body of people (the trustees) who took responsibility for management and control;
- ✓ trustees had clear reporting lines with sub-committees and staff, to ensure that all parties remained well informed;
- ✓ charity business was handled on a regular and timely basis;
- ✓ comprehensive induction procedures for new trustees were in place;

- ✓ the charities had adequate procedures to deal with conflicts of interest; and

- ✓ the charities made information about their affairs freely available.

11 We made a total of 57 recommendations to the 21 bodies visited relating to corporate governance issues, that trustees agreed to implement. These are summarised at Appendix 6. Areas covered by our recommendations included:

- the establishment by *corporate trustees* of a charitable funds sub-committee, in accordance with statutory rules established by the Secretary of State for Health, emphasising the distinction between the administration of charitable funds and exchequer funds;

- ensuring that trustees are kept fully informed about business conducted by sub-committees and ratify any decisions that they take;

- by trustees reviewing their arrangements for delegation, to satisfy themselves that an appropriate balance exists between authorisation procedures devolved to fund advisors and trustee oversight;

- avoiding trustees acting as fund advisors where it could lead to a conflict of interest. Where this is not possible arrangements being made to ensure that all interests are properly declared and dealt with in an appropriate fashion;

- trustees introducing formal measures to ensure that documents setting out the charities' rules and procedures are regularly updated;

- introducing comprehensive induction procedures for all new trustees, including formal briefings and the provision of relevant Charity Commission and NHS Executive guidance and background information about the charity;

- maintaining up to date registers of interest covering trustees, support staff and fund advisors, and non-financial as well as financial interests; and

- reviewing what could be done to improve communication and make information about the charities more widely available.

Financial control

12 It is important for trustees to ensure that the resources of the charity are managed securely and economically and deployed to the best advantage of users and beneficiaries.

13 Overall we found that the charities we visited had adequate controls to ensure that business was conducted in accordance with the law and to minimise the risk of a breach of trust. We identified many examples of good practice, where;

- ✓ charities had reliable financial systems based on proper books and records, conforming to the requirements of Part VI of the Charities Act 1993;
- ✓ charities had comprehensive guidance and procedure notes, covering background information on the charity, how to apply for funds, handling receipts, fundraising, and the financial accounting system;
- ✓ trustees had agreed policies for the use of reserves, to allow them to demonstrate that they were not accumulating funds unnecessarily and to help them to manage their reserves;
- ✓ charities had adequate planning and budgeting arrangements, to give trustees assurance that funds were being used in accordance with the objectives of the charity and to help prevent the unplanned growth of fund balances;
- ✓ accurate and timely management information was provided to trustees;
- ✓ investments were managed by professional investment managers;
- ✓ trustees had in place effective internal and external audit arrangements;
- ✓ trustees had set out clearly their objectives for expenditure;
- ✓ trustees had taken steps to control all funds within the charity even when some of their duties had been delegated to fund advisors; and

- ✓ trustees maintained adequate control of fund-raising activities.

14 We also found a number of areas where there was scope for further improvements by trustees and to the 21 bodies we visited we made a total of 100 recommendations concerning financial controls, that trustees said that they planned to implement. Appendix 6 provides further details. Our recommendations covered the following areas:

- regularly reviewing guidance notes and circulating them as widely as possible amongst charity and hospital staff;
- developing an integrated reserves policy, forward plan and budget;
- having planning and budgeting arrangements that at least meet the recommendations of the Charity Commission;
- requesting management information on spend in the period, total spend to date, comparative figures for the previous year, budget for year profiled by month, large or unusual transactions, significant donations, use of the Chairman's (or other officer's) discretionary authority, investment performance, and slow moving or overdrawn funds;
- regularly monitoring and reviewing the performance of their investment managers;
- periodically testing the market for the investment managers and other service providers;
- making arrangements to ensure that all internal and external audit reports are made directly to them; and
- developing guidelines for fund advisors and potential grant applicants on what expenditure is appropriate to the charity.

15 A summary of all our recommendations is provided at Appendix 6.

Supervision and accountability

16 Our largely positive evidence on the bodies' corporate governance and financial control arrangements provides reasonable assurance that the current arrangements for supervision and accountability are operating effectively. On the basis of our findings there is no case to be made now for greater regulation.

17 Further, we found that the NHS Executive (acting on behalf of the Secretary of State) and the Charity Commission have worked together to ensure that, in the discharge of their responsibilities in relation to charitable funds associated with the NHS, there is no significant duplication of effort.

18 In accordance with the Charities Act 1993, it is the Charity Commission that regulates charitable funds associated with the NHS. The Commission has issued specific guidance to the trustees of these funds on the duties, responsibilities and obligations which charity law imposes on them in their capacity as a charity trustee. Our investigation indicated that there was a perceived need for further guidance on certain issues such as reserve policies and research funds. Since our visits to trustee bodies, further guidance on these subjects has been published in the NHS Executive's Funds Held on Trust: 1999-2000 Manual for Accounts and the Charity Commission's Exposure Draft of Accounting and Reporting by Charities: Statement of Recommended Practice.

19 The NHS Executive does not in practice duplicate this regulatory function and has no legislative powers to do so. However, on behalf of the Secretary of State, it continues to exercise beneficially the legislative powers to appoint and remove trustees and also to transfer property between trustees, for example when there is a re-organisation of the associated NHS Trust or Health Authority. Where there is an obvious overlap of functions, for instance where trustees are required to submit annual accounts to the NHS Executive and the Charity Commission, by agreement between both organisations the accounting requirements are virtually identical and do not impose significant additional burdens on the trustee bodies concerned, except for the smallest charities which otherwise would not need to submit annual accounts.

Part One: Introduction

Funds held on Trust

1.1 When the NHS was established in 1948 the Secretary of State for Health also took on responsibility for administering a large number of charitable funds previously held by voluntary and local authority hospitals. The development of the NHS into its present day form has been accompanied by the establishment of over 500 NHS Trusts and Health Authorities. As the NHS has evolved, administration of charitable funds has been passed to trustee bodies linked to NHS Trusts and Health Authorities. The trustees administer these funds together with new charitable trusts which have been created since the formation of the NHS.

1.2 While the charitable funds are linked to an NHS body, they are independent of the trust or authority and are able to receive new funds and incur expenditure in accordance with their governing documents. Collectively the charitable assets held by the trustees are referred to as the "Funds Held on Trust". Further details on the history of funds held on trust can be found in Appendix 1. Figure 1.1 summarises the key responsibilities of the Secretary of State, the Charity Commission and trustees, which are set out in detail at Appendix 2.

Responsibilities of Trustees

1.3 Trustees are responsible for the administration of the individual charities and for ensuring that assets are properly managed, controlled and safeguarded in accordance with charity and trust law. They are also responsible for completing and submitting audited annual accounts to the Secretary of State for Health and the Charity Commission.

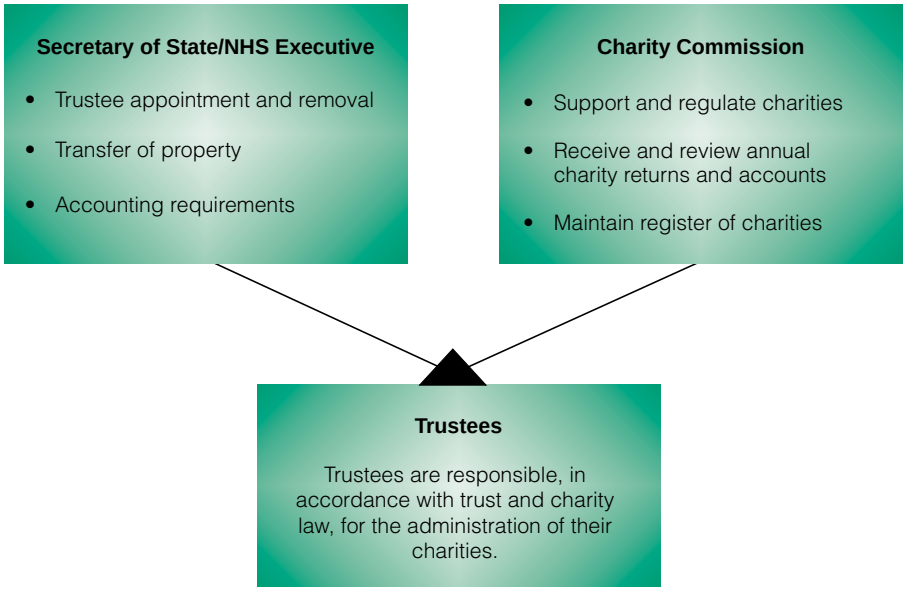
1.4 Trustees may be:

- A body of *special trustees*: under the NHS Reorganisation Act 1973, funds held historically by many teaching and university hospitals were put under the control of *special trustees* appointed by the Secretary of State;

Key responsibilities for Funds Held on Trust

Figure 1.1

Figure 1.1 illustrates the key responsibilities of the Secretary of State/NHS Executive, the Charity Commission and trustee bodies for Funds held on Trust.



Source: Statement of Responsibilities and Accountabilities (Appendix 2)

- *Corporate trustees*: where an NHS body corporate for example, an NHS Trust, Health Authority or Special Health Authority, acts through the directors and possibly others as a *corporate trustee* of charitable funds. The non-executive board members are appointed by the Secretary of State; and

- Section 11 trustees: under section 11 of the NHS and Community Care Act 1990, the Secretary of State can appoint trustees to hold and administer the charitable funds associated with a NHS body. At present there are no Section 11 trustees, although the Secretary of State is currently in consultation with existing bodies of *special trustees* regarding such appointments. This would help to standardise arrangements and remove some existing anomalies that have developed, for example, where organisational changes have caused misalignments between NHS bodies and their associated charities. A decision has so far been taken in a number of cases to replace bodies of *special trustees* with section 11 trustees, as from 1 April 2000.

1.5 Trustee appointments have recently been brought into line with the recommendations of the Committee on Standards in Public Life "First Report of the Committee on Standards in Public Life" – Volume 1: Report, Cmnd 2850, May 1995, and are now publicly advertised, open to competition and involve independent scrutiny. Although trustee appointments do not fall under the jurisdiction of the Commissioner for Public Appointments, the NHS Executive does seek to follow the Commissioner's guidance. At least two posts on each trustee body are reserved for a non-executive nominee from the host health authority and NHS Trust. As NHS non-executives they have been through a formal selection process involving independent scrutiny.

1.6 Unless otherwise specified, the term "trustee" is used in the remainder of this report to refer to the types of trustee described in paragraph 1.4.

Responsibilities of the Secretary of State

1.7 Since 1948 the Secretary of State for Health has been responsible for bringing forward legislation on the appointment and removal of trustees; the terms of their office; the transfer of property between trustee bodies; and the preparation and audit of accounts for the charitable funds. The responsibilities and powers of the Secretary of State in respect of the charitable funds are exercised through the NHS Executive.

Responsibilities of the Charity Commission

1.8 The Charity Commission administers the regulatory framework for all English and Welsh charities, including charities associated with the NHS. This includes the maintenance of a register of charities and oversight of the submission of annual returns and accounts in accordance with legislation. A list of current guidance issued by the Commission is at Appendix 3.

Summarised Account of the Funds Held on Trust

1.9 Under s98 (4) of the NHS Act 1977 the Secretary of State must prepare the Summarised Account of Funds Held on Trust. The Chief Executive of the NHS as Accounting Officer signs the Account. His relevant responsibilities are set out in the Accounting Officers' memorandum issued by the Treasury and published in "Government Accounting". The Account is transmitted on or before 30 November to the Comptroller and Auditor General who examines and certifies it, and lays a copy of it together with his report before both Houses of Parliament. The main components of the account are considered in the following paragraphs.

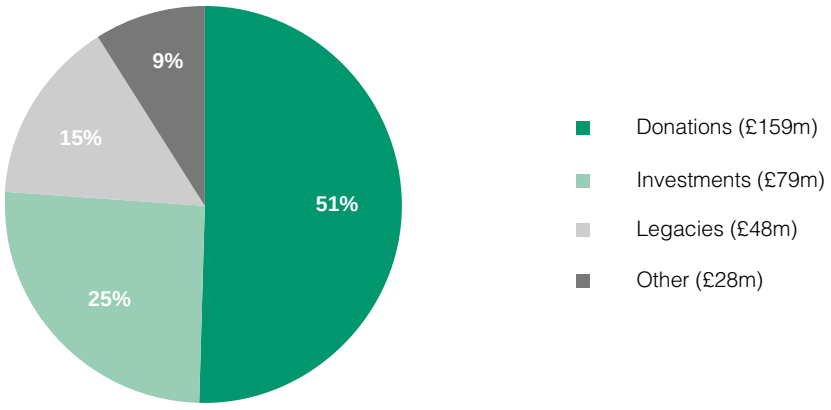
Income

1.10 The Summarised Account for 1998-99 showed that the charities had income of some £314 million. Figure 1.2 shows the breakdown of this figure between the various income types.

Analysis of income received by charitable funds in 1998-99

Figure 1.2

Figure 1.2 shows that just over 50 per cent of income received by charitable funds in 1998-99 was from donations.



Source: Summarised Account of Funds Held on Trust 1998-99

Expenditure

1.11 Charity law recognises as a charitable purpose the relief of those who are ill including the support of those who care for the sick and requires that charitable activity must be for the public benefit. In practice this gives trustees a wide choice of potential subjects and projects that can be supported from funds in their care. The law normally requires that charities should not use their resources (unless the governing document clearly permits) to do what is already being done by statutory services financed out of rates or taxes; but they may supplement those services by providing additional benefits beyond the actual statutory provision. Within this framework, in 1998-99 the charities spent some £322 million in support of the NHS. Figure 1.3 provides examples of the various types of charitable support.

Examples of expenditure from charitable funds.

Figure 1.3

Category of support	Specific examples
Research projects	■ Three year grant for the study of "Neurotrophins and Spinal Cord Regeneration". ■ In-Vitro Fertilisation (IVF) Research Fund.
Capital developments	■ Contribution to the building costs of a new Endoscopy Department.
Purchase of equipment	■ Renal dialysis machines. ■ Toys for pre-school children's crèche.
Education and training	■ Contribution to the establishment of a Dental Education Trust to provide additional support for the training of dentists and the promotion of dental education.
Improvements to facilities & services	■ Improvements to the ward environment, better accommodation for relatives and satisfactory standards of furnishing. ■ Funding for two bereavement co-ordinators

Source: National Audit Office Analysis

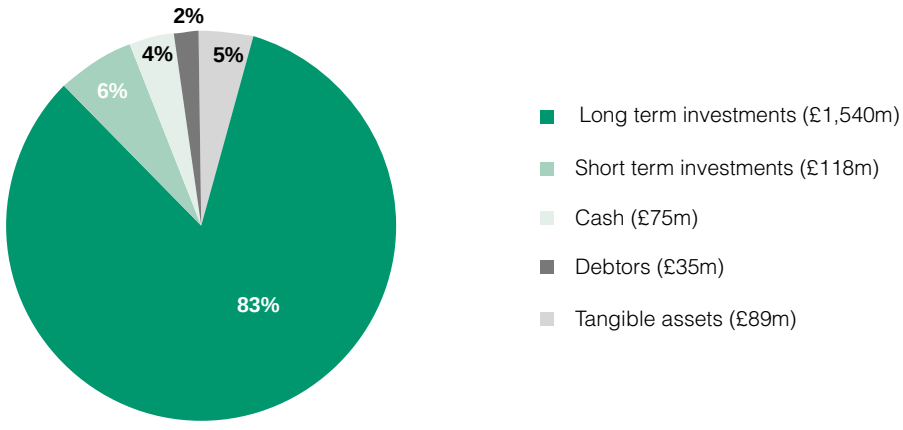
Assets

1.12 As at 31 March 1999 the total gross assets held by trustee bodies included in the unaudited Summarised Account, amounted to £1.86 billion. Figure 1.4 provides details of the composition of this figure.

Gross assets held (by type) by NHS bodies for charitable purposes

Figure 1.4

Figure 1.4 shows that in 1998-99 around 85 per cent of assets held by NHS trustee bodies for charitable purposes were long term investments.



Source: Summarised Account of Funds Held on Trust 1998-99

1.13 Assets held by the trustee bodies fall into three categories. These are defined in Figure 1.5

Charitable fund categories

Figure 1.5

Unrestricted Funds

Nearly all charities have a fund which is available to the trustees to apply for the general purposes of the charity as set out in its governing document. This is the charity's "unrestricted" fund (sometimes called a "general" fund) because the trustees are free to use it for any of the charity's purposes. Income generated from assets held in an unrestricted fund will be unrestricted income.

The trustees may set aside part of the charity's unrestricted funds to be used for particular purposes in the future. Such sums are described as "designated" funds and should be accounted for as part of the charity's unrestricted funds. The trustees have the power to reallocate such funds within unrestricted funds unless and until expended.

Restricted Funds

Many charities hold funds that can only be for particular purposes within their objects. These are restricted funds and have to be separately accounted for. The restriction may apply to the use of income or capital or both. Income generated from assets held in a restricted fund will be subject to the same restriction unless the terms of the original restriction specifically says otherwise (for example, the expressed wishes of a donor or the terms of an appeal) or the restricted fund is an endowment fund, the income of which is expendable at the discretion of the trustees.

Endowment Funds

Another form of restricted fund is an "endowment", which must be retained for the benefit of the charity as a capital fund. Legally it cannot be expended as if it were an income fund. Where the trustees must permanently maintain the whole of the fund it is known as permanent endowment (though it is a legal requirement that it must be used to pay investment management fees relating to the endowed funds). In some instances the trustees may have a power of discretion to convert capital into income in which case the fund is known as expendable endowment.

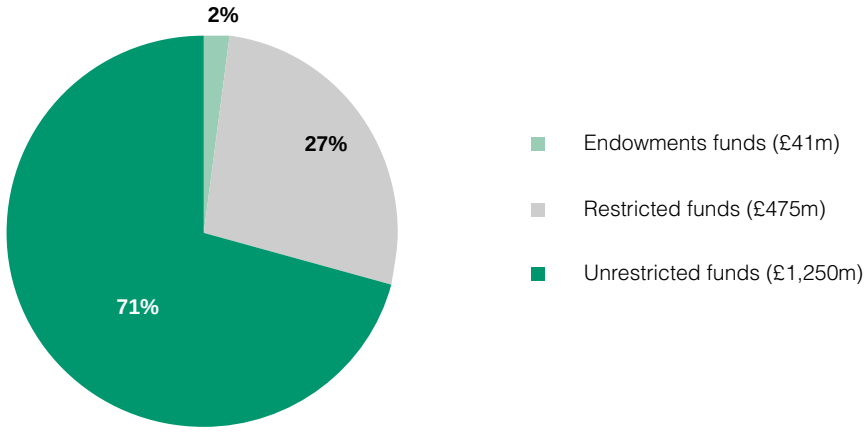
Source: Charity Commission; Accounting and Reporting to Charities: Exposure Draft of Recommended Practices, December 1999.

1.14 After taking account of liabilities of some £92 million, the net assets held on trust were £1.77 billion. Figure 1.6 shows the relative size of each of the main asset categories.

Nature of charitable funds held by NHS bodies - £m

Figure 1.6

Figure 1.6 shows that at 31 March 1999, 70 per cent of net assets were held in unrestricted funds.



Source: Summarised Account of Funds Held on Trust 1998-99

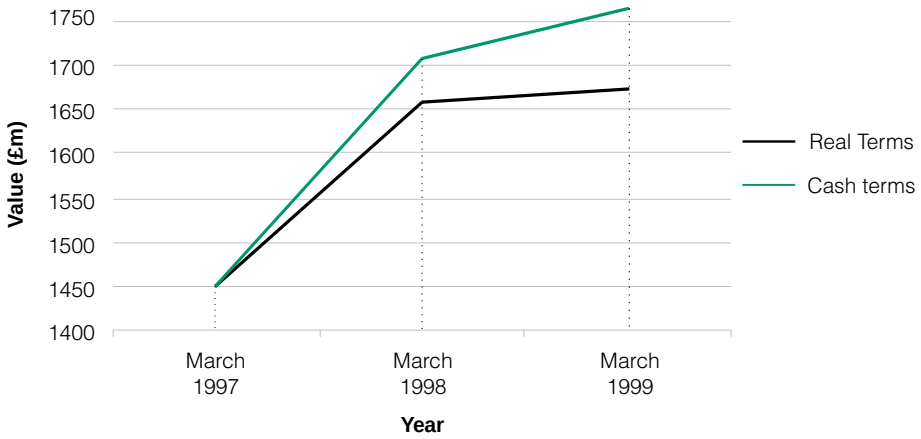
Increase in the value of assets held

1.15 Since 1996-97, when all charities were first required to disclose the market value of their investments in their annual accounts, the value of net assets held by trustees has increased from £1.45 billion as at 31 March 1997 to the £1.77 billion reported as at 31 March 1999. Figure 1.7 shows that there has been a real terms increase of £220 million, equivalent to 15 per cent, since 31 March 1997.

Real terms growth of charitable net assets

Figure 1.7

Figure 1.7 shows that since 31 March 1997 there has been a real terms increase of £220 million, equivalent to 15 per cent, in the value of net assets held by trustees.



Source: Summarised Account of Funds Held on Trust 1997-98 and 1998-99. Adjustment of cash figures to real terms by application of HM Treasury's GDP Deflator Index.

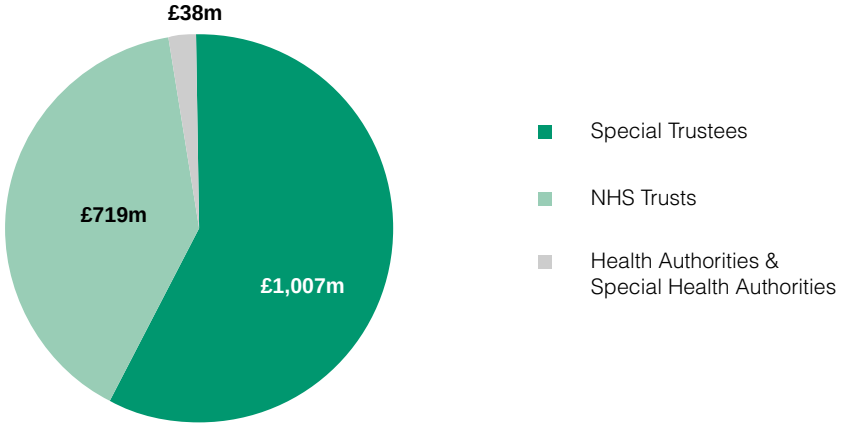
Who is holding the assets

1.16 Of the £1.77 billion of net assets recorded in the Summarised Account for 1998-99, 24 *special trustee* bodies held £1 billion or 57 per cent (see Figure 1.8). Around £1.5 billion or 84 per cent was held by just 75 NHS trustee bodies, the remaining 414 holding £74 million or 16 per cent of the total (see Figure 1.9). Historically, this concentration of funds in just 15 per cent of trustee bodies is mainly the result of the bequest of substantial sums of money or assets to the charities concerned.

Distribution of assets between types of trustee body

Figure 1.8

Figure 1.8 shows that special trustee bodies held the largest proportion of funds with some £1 billion at 31 March 1999

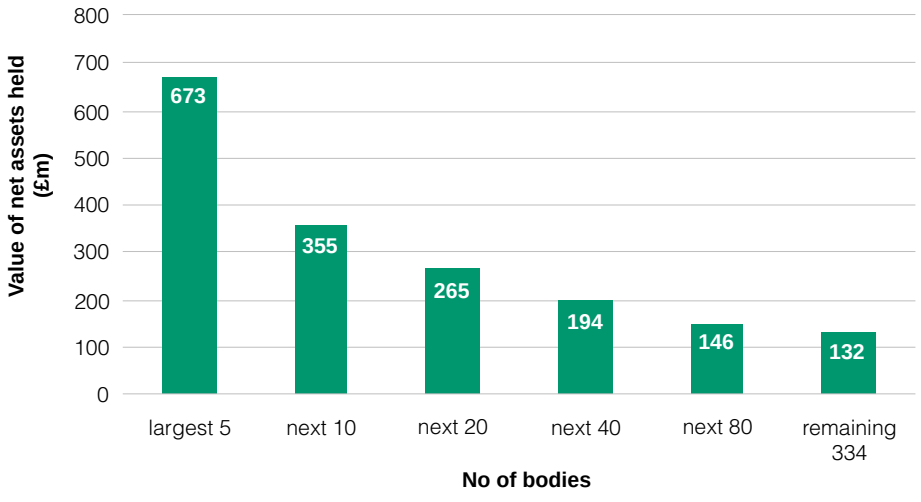


Source: Summarised Account of Funds Held on Trust 1998-99

Concentration of assets in 75 trustee bodies

Figure 1.9

Figure 1.9 shows that approximately £1.5 billion was held by just 75 NHS trustee bodies. This represents 84 per cent of the total net assets held by all NHS trustee bodies as at 31 March 1999



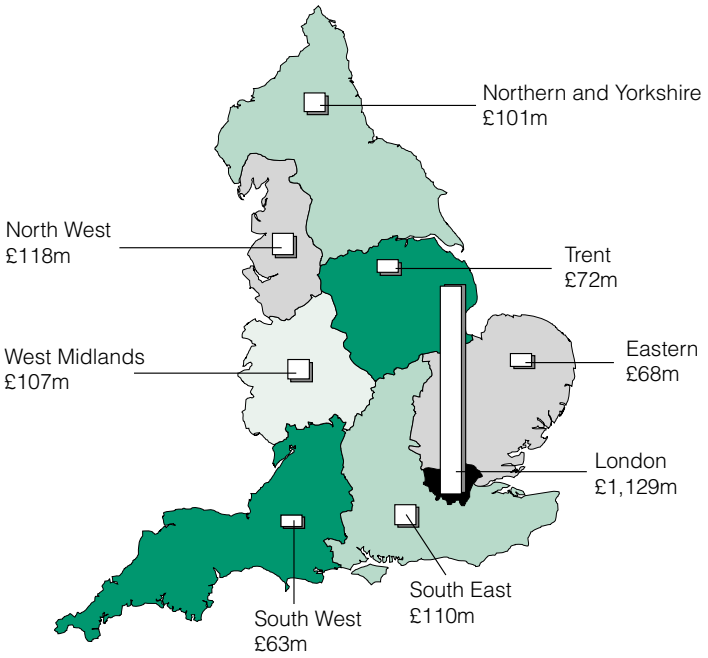
Source: NHSE figures as at 31 March 1999

1.17 Figure 1.10 illustrates the geographical spread of net assets held by trustee bodies at 31 March 1999. The concentration of assets in the London area is, as indicated at paragraph 1.16, largely the result of significant bequests to London-based special trustees, although it should also be noted that several of these London NHS bodies are providing services on a national basis.

Net assets held by trustee bodies at 31 March 1999

Figure 1.10

Figure 1.10 shows that at 31 March 1999, around 65 per cent of net assets were held by trustee bodies in London.



Source: Summarised Account of Funds Held on Trust 1998-99

Scope of NAO study

1.18 We investigated whether there are effective controls over charitable funds associated with the NHS. The examination focussed on three issues:

- **corporate governance**: are the charitable funds administered in accordance with the principles of good corporate governance?
- **financial control**: are there adequate controls over the transactions, assets and liabilities? and
- **supervision**: are current arrangements for the supervision and accountability of the funds held on trust satisfactory?

1.19 There are many other registered charities that raise funds and make grants to support the NHS that are not included in the Summarised Account of Funds Held on Trust. Examples include medical research charities, hospital Leagues of Friends and some grant-making charities. No summarised information is held centrally about their numbers or the value of their funds. As the Comptroller and Auditor General does not have access to their books and records they are outside the scope of this report.

Methodology

1.20 We visited 21 trustee bodies collectively holding charitable funds in excess of £800 million, representing about 45 per cent by value of the net assets recorded in the 1998-99 Summarised Account. Our sample was taken from the 180 bodies holding fund balances greater than £1 million and was weighted towards the larger ones. Therefore not all our conclusions maybe relevant to the smaller bodies. At each body we:

- interviewed trustees and key finance and administrative staff;
- reviewed documentation on corporate governance and fund management arrangements; and
- examined a sample of transactions.

1.21 Following each visit we sent an agreed report of our findings and recommendations to the trustees.

1.22 We examined the current regulatory and supervisory framework applicable to trustee bodies. Further details of the methodology we used are at Appendix 4. This includes a list of the locations visited, the method used to select the sample, and an analysis of the issues examined.

1.23 Our findings, which appear in Parts 2 to 4 of this report, were discussed with an Expert Panel of people from the NHS Executive, the Charity Commission, special trustees, corporate trustees and the Healthcare Financial Management Association. Members of the Expert Panel acted as individuals rather than as representatives of their organisations. Details are shown at Appendix 5.

1.24 A summary of our recommendations to trustees is at Appendix 6.

Part 2: Corporate governance in charities associated with the NHS

Key principles of corporate governance

2.1 Charities must meet certain legal and regulatory requirements in carrying out their activities. In addition, the public expects charities to operate high standards in the management of their resources and in the delivery of their charitable aims. It is the trustees who are responsible for ensuring that the charity is operated in an appropriate manner. To this end, corporate governance provides a framework within which organisations are directed and controlled, including the setting of financial policy and overseeing its implementation. The Charity Commission has issued guidance to charities on the responsibilities of charity trustees, to help promote high standards of corporate governance. In 1994 the Commission issued specific guidance for NHS charitable funds, known as the "Blue Book", dealing with aspects of charity law concerning health service bodies (see Appendix 4).

2.2 In this part of the report we consider the arrangements that trustees have set up to secure high standards of corporate governance, against three key principles of Integrity, Accountability and Openness as identified by the Nolan Committee on Standards in Public Life (see figure 2.1).

Key principles of corporate governance

Figure 2.1

Key principles of corporate governance

Integrity	Trustees should not place themselves under any financial or other obligation to outside individuals or organisations that might influence them in the performance of their duties as trustees.
Accountability	Trustees are accountable for their decisions and actions and must submit themselves to whatever scrutiny is appropriate to their office.
Openness	Trustees should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider interests of the charity clearly demands.

Source: "Spending Public Money: Governance and Audit Issues"; Cm 3179, March 1996

We identified many examples of good practice during our visits to trustees

2.3 Overall we found that the trustees we visited had made substantial progress in adopting the principles of good corporate governance, often in line with guidance issued within the NHS. We identified many examples of good practice, covering a range of activities. These are summarised below:

- ✓ the charity is run by a clearly identifiable body of people (the trustees) who take responsibility for management and control;
- ✓ trustees have clear reporting lines with sub-committees and staff to ensure that all parties remain well informed;
- ✓ charitable business is handled on a regular and timely basis;
- ✓ trustees have adequate resources to help them maintain a high standard of management and control;
- ✓ the charity has clearly documented rules by which it is run;
- ✓ comprehensive induction procedures for new trustees are in place;
- ✓ the charity has adequate procedures to deal with potential conflicts of interest; and
- ✓ the trustees make information about their affairs freely available.

2.4 We also made 57 recommendations to help improve corporate governance procedures at the 21 bodies we visited, that trustees agreed to implement. Further details are given at Appendix 6.

The charity is run by a clearly identifiable body of people

Corporate trustees

2.5 The board of a NHS body administers the exchequer funds provided by Government, and is made up of a number of executive and non-executive directors. The board may also act as *corporate trustee* for any charitable funds associated with the NHS body. Over 95 per cent of charities included in the NHS Summarised Account of Funds Held on Trust are managed by a *corporate trustee*. Together these held some £757 million representing 43 per cent of net assets held at 31 March 1999. We visited 12 *corporate trustee* bodies and found that in all but three, the *corporate trustee*, recognising that the charitable funds are distinct from the exchequer monies administered by the NHS body, had established a committee to deal with matters relating to the charitable funds.

2.6 Typically the 'charitable funds' committee would be made up of members of the NHS body, including at least one non-executive director, and report directly to the full board of that body acting as a *corporate trustee*. The extent to which the *corporate trustee* had delegated administration of the charity to the committee, varied considerably. Some committees acted purely in an advisory capacity to the *corporate trustee*, while others handled the charity's administration.

2.7 The bodies that did not have a charitable funds committee in place dealt with the business of the charity as an agenda item at board meetings of the NHS body. While this can be an efficient administrative approach, it creates risks. That is, board members may not be seen to be acting separately in the conduct of charitable and NHS business, and may not distinguish between the different requirements placed on them for each of these roles. A further risk is that, under such a procedure, the charity business may be given a relatively low priority and overshadowed by issues relating to the exchequer business of the NHS body.

2.8 We consider that where practical the establishment of a charitable funds committee by a *corporate trustee* should help to make it clear that the administration of charitable funds is distinct from its exchequer funds. The committee should be set up in accordance with procedures for sub committees laid down in the National Health Service Trusts (Membership and Procedures) Regulations 1990. Such an arrangement emphasises that the *corporate trustee* has separate and distinct responsibilities for the administration of the charitable funds and helps ensure that due weight is given to the business of managing those funds.

2.9 We found that very few of the *corporate trustees* visited had set up committees, other than the over-arching charitable funds committee (paragraph 2.5), to deal with specific aspects of the charity's administration. Instead we noted that charitable business of *corporate trustees* dealt with outside the charitable funds committee was either handled by the *corporate trustee* or a relevant sub-committee of the associated NHS body - for example the Audit Committee.

2.10 We consider that making use of the NHS body's sub-committees is a practical and efficient way of responding to the resource and time constraints that trustees may be under. However, to be effective, trustees should ensure that sub-committees deal with charitable activities in accordance with procedures laid down in the National Health Service Trusts (Membership and Procedures) Regulations 1990. In particular, if not already in place, sub-committee terms of reference and delegated authorities should include specific coverage of charitable funds. In addition, clear reporting lines are required to ensure that trustees remain in control of the charitable business handled in these sub-committees.

Special trustees

2.11 Twenty-four bodies of *special trustees* appointed by the Secretary of State held net assets of £1,007 million, some 57 per cent of the total funds held on trust as at 31 March 1999. We visited nine of these. We found that as well as holding full meetings of the *special trustee* body most of the *special trustees* had set up sub-committees to assist the conduct of their business, this is in accordance with the rules set out in their governing documents.

2.12 The purpose of these sub-committees is to provide a focus for certain areas of the charity's business. This has helped the trustees to deal efficiently with some of the more technical and demanding aspects of their duties, without the need for a full meeting of the trustees. Many of the sub-committees we observed were operating within clear delegated authorities and terms of reference approved by the trustees. Examples of sub-committees set up by *special trustees* are shown in Figure 2.2.

Examples of sub-committees established by special trustees

Figure 2.2

Special trustee sub-committees	Role
Audit Committee	To appraise and monitor key issues of financial reporting, internal controls and corporate governance.
Investment Management Committee	To determine investment policy, and monitor investment performance.
Fundraising Committee	To control and monitor fundraising activity taking place on behalf of the charity.
Property & Accommodation Committee	To oversee issues relating to operational and investment property held by the charity.
Scientific Advisory Committee	To assess project proposals and undertake peer review.
Finance & General Purposes Committee	To consider issues relating to the financial management of the charity and, within delegated authorities, to scrutinise proposals for the use of funds.

Source: NAO analysis

Trustees have clear reporting lines in place

2.13 Trustees need to be well informed about the business of the charity if they are to meet their responsibilities effectively. Consequently, it is important that clear reporting lines are established and appropriate arrangements exist to enable trustees to oversee actions taken on their behalf.

2.14 Overall, we found clear lines of communication and reporting in the bodies we visited. Most of the charities, administered by both *corporate trustees* and *special trustees*, had formal procedures to ensure that all decisions taken by sub-committees were reported back to and approved by the full body of trustees. However, in two cases sub-committees were allowed to take decisions that affected the charity without any formal arrangements to report their actions to the full body of the *corporate trustee*. At one of these the associated NHS Trust's audit committee was responsible for approving the charity's expenditure; this is inappropriate to the role of an audit committee and creates a risk of conflicts of interest. As a consequence of our visit, appropriate arrangements have been introduced and the potential conflict resolved.

2.15 We encourage all trustees to adopt the good practice examples given below.

Measures to ensure trustees remain well informed

- sub-committee meetings are scheduled shortly before meetings of the full trustee body;
- the Chair of the sub-committee is required to report formally on any decisions taken, to the next meeting of all trustees;
- decisions taken by sub-committees require ratification by all trustees; and
- sub-committee minutes are tabled at full meetings of the trustees.

Charity business is conducted on a regular and timely basis

2.16 To administer a charity properly, trustees should meet regularly. Frequency of meetings will depend on the size of the charitable funds being administered and the number and complexity of its transactions. Two important criteria to be considered in determining the frequency of meetings are:

- the amount of business that can be reasonably completed at one meeting; and
- the need to avoid any undue delays to the charity's administration that might lead to a failure to meet legal and regulatory requirements or poor management and use of the charity's resources.

2.17 We found that most of the bodies we visited had struck a reasonable balance between the demands they placed on the valuable time of their trustees and the need to transact business efficiently. The trustees of all of these bodies met at least twice a year, and more frequently in most cases. It was common for trustee meetings to be arranged at least one year in advance, because of the limited availability of trustees. Special meetings were arranged if urgent issues arose. A similar pattern applied to the arrangements for meetings of sub-committees.

Trustees have adequate resources to help them maintain a high standard of management and control

2.18 All of the bodies we visited had staff in place to assist the trustees in their work. We found that at the smallest charities staff normally work part of their time for the trustees and part for the associated NHS body. In larger bodies staff tend to work full time on charitable business, although for convenience they are employed normally by the NHS body and their salary costs reclaimed from the charity. Typical activities undertaken by support staff are illustrated below in Figure 2.3.

Typical support staff activities

Figure 2.3

Maintenance of financial accounting systems

Production of annual accounts

Compilation of management information

Assessment/scrutiny of expenditure proposals to ensure propriety

Source: NAO analysis

Preparation of committee papers, including agendas and minutes

2.19 In addition to the use of support staff, most charities delegated the day to day operation of individual funds within the charity to fund-advisors. These were generally senior staff members of the associated NHS body, working in the particular field that the individual fund had been established to support.

2.20 Expenditure proposals were normally initiated by fund-advisors operating within delegated authorities, before being passed to the next stage in the assessment and authorisation process. For example, for further consideration by finance staff or by the charitable funds committee. We found that generally these arrangements were working effectively, providing a structured approach to charitable business in accordance with delegated authorities and written instructions. However, we also found that certain bodies allowed fund-advisors to manage funds with little or no reference to the trustees. For example, we noted cases where fund-advisors were responsible for approving expenditure from income that they themselves had generated. We also found cases where expenditure was authorised and committed by fund-advisors who then retrospectively applied for payment from charitable funds.

2.21 Delegation to fund-advisors can assist efficient management and can help to secure effective spending, particularly if the fund-advisor has specialist knowledge in the area to be funded. But such arrangements increase the risk of

inappropriate commitments being entered into, leading to unplanned or irregular expenditure. Therefore we consider that there should be clear delegations to fund-advisors who are able to approve of expenditure and enter commitments without prior scrutiny by trustees. But it is important that this should be coupled with regular reporting to trustees on decisions taken and commitments entered into.

2.22 Most *corporate trustees* included executive directors who also acted as fund-advisors for individual funds within the charity. Some bodies of *special trustees* also included individuals that acted as fund advisors. In these circumstances the people concerned are in a position, as fund-advisors, to apply to use funds for projects in which they have an interest and, as trustees, to take part in the subsequent approval process. We found no evidence to indicate any improper activity in the cases we reviewed, but we believe that these conditions create a potential conflict of interest that the charities concerned have generally not previously recognised. In our view, trustees should not act as fund-advisors where this could cause a conflict of interest.

The charity has clearly documented rules by which it is run

2.23 With two exceptions, all the trustee bodies we visited had written rules and procedures governing the formal conduct of the charity's business, set out in standing orders, financial instructions and procedure or guidance notes. In both of these cases the trustee body has agreed to introduce the required documents.

2.24 We noted that trustees had often adopted the standing orders and financial instructions of the associated NHS body. This approach worked best where the NHS documentation had been adapted to include specific reference to and coverage of charitable funds. Some of the key matters covered by trustees' written rules are set out below:

Key matters covered by trustees' rules

Standing orders

- ✓ procedures for trustee meetings - for example, quorum, notice of meetings, minutes, voting arrangements;
- ✓ appointment of Chairman;

- ✓ establishment of committees - details about how committees can be created;
- ✓ tendering and contracting - rules concerning the placing of business; and
- ✓ interests of trustees - procedures for handling potential conflicts of interest.

Standing financial instructions

- ✓ audit arrangements;
- ✓ annual report and accounts;
- ✓ procedures to ensure proper controls over income and expenditure;
- ✓ establishment of new funds within the umbrella charity;
- ✓ investments - procedures relating to the conduct of investments and their management;
- ✓ budgets, budgetary control and monitoring; and
- ✓ banking arrangements.

Procedural guidelines

- ✓ background information on charity - for example, constitution and structure of the funds;
- ✓ how to apply for funds - instructions for those wishing to incur expenditure from the charitable funds;
- ✓ handling receipts - procedures for dealing with donations, legacies and cash receipts;
- ✓ key policies - for example, reserves and investment policies;

- ✓ fundraising - guidelines on the procedures to follow when undertaking fundraising; and

- ✓ financial accounting system - desk instructions for finance staff.

2.25 During several of our visits we noted that the documents setting out rules and procedures had not been regularly reviewed. In these cases we recommended that the trustees should introduce formal procedures to ensure regular update. For example, this could be done by including an annual review of the documents as an agenda item at trustee meetings. Trustee bodies have responded positively to this recommendation.

2.26 We encourage all trustees to ensure that arrangements for the conduct of their business are appropriate and formally recorded.

Induction procedures for new trustees

2.27 To be effective, new trustees need a sound knowledge of the purposes of the charity, the trusts and procedures that govern the charity's actions, and the nature and condition of the property of the charity. The Charity Commission recommend that new trustees should:

- study the governing document or documents of the charity;

- meet with fellow trustees and officers of the charity to ask about its activities, funding and property;

- study the latest annual report and accounts;

- be aware of their duties and responsibilities under trust and charity law; and

- show they accept their responsibilities by signing the minute book.

2.28 The majority of bodies we visited had no formal induction arrangements in place for new trustees. However, by contrast two had provided comprehensive induction packs, containing relevant Charity Commission and NHS Executive guidance and background information about the charity. Others provided a formal briefing, for example, from the chair of the trustees. We consider that these are the

most effective means to ensure that trustees understand the nature of the charitable business and their responsibilities, and encourage bodies with limited or no induction arrangements to adopt this good practice.

The charity has adequate procedures to deal with potential conflicts of interest

2.29 Many of the bodies we visited had introduced measures to reduce the risks of potentially damaging conflicts of interest in line with legal requirements. We saw examples where the procedures to follow in the event of a conflict of interest arising during a trustee meeting were set out in the charity's standing orders. It was widely recognised as good practice for the trustee concerned to declare an interest and withdraw from the meeting while the remaining trustees considered the relevant issue, and for the withdrawal to be noted in the minutes of the meeting.

2.30 Registers of interest had been introduced at almost all the bodies. In several cases they had utilised the register compiled by the associated NHS body. In a small number of cases we were able to make recommendations to trustees to:

- broaden the scope of the register of interests, for example, to include support staff and fund advisors;
- introduce formal procedures so that the register is regularly updated; and
- clarify what interests should be included in the register, for example, non-financial as well as financial interests.

In every case the trustee has indicated that appropriate action will be taken.

2.31 During our visits we identified two instances where we believe that clear conflicts of interest had arisen. These are described below.

Case 1

Until 1999 a chairman of trustees also worked for the charity's investment manager and was personally responsible for the charity's investment account. A second trustee also worked for the same investment manager. Committee meetings regularly dealt with issues concerning the investment managers, including discussion and approval of the manager's fee. The two trustees working for the investment manager took a full part in these proceedings. At many meetings it was not possible to achieve a quorum without the involvement of these two trustees. The Chairman of trustees has now retired from the investment advisor, while the second trustee remains a director of the company although without direct responsibility for the trustees' account. The trustees have decided to maintain this arrangement pending a forthcoming reorganisation, under Section 11 of the NHS and Community Care Act 1990.

Case 2

Two members of a *corporate trustee's* charitable funds committee were also trustees of another charity linked to the hospital. Dual membership was intended to protect the interests of the hospital. The *corporate trustee* received a request for a loan towards administrative support of approximately £10,000 from the linked charity. The charitable funds committee approved the request in principle although no papers were submitted to the committee to justify the loan. There was no evidence that the relevant committee members declared their interest in the other charity or took no part in the decision to grant the loan in principle. The *corporate trustee* informed us that before execution of the loan a proper request for release of funds would have needed to be made. However the linked charity eventually withdrew the loan request, on the grounds that it was no longer needed.

The charity makes information about its affairs widely available

2.32 Charitable bodies associated with the NHS are required to compile and disseminate certain information. For example, they must complete statutory annual accounts for submission to the NHS Executive and provided that the funds are over a certain size, to the Charity Commission. In addition, they must provide a copy of their annual accounts to members of the public on request. In other areas openness is limited, for example, currently there is no requirement for trustees to open any of their meetings to the public. However, some bodies have been proactive in introducing measures to encourage greater openness as illustrated below.

Measures to improve communication and make information more widely available

- ✓ allowing the public to attend meetings of the trustees;

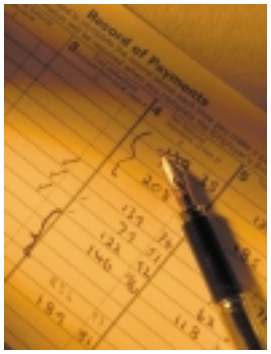
- ✓ devoting a section of the associated NHS body's annual general meeting to a report on the use of charitable funds;

- ✓ preparing reports on the charity's activities to be sent out to donors and potential donors; and

- ✓ publicising the work of the charity and inviting bids for the use of its funds.

2.33 In pursuance of greater openness, we encourage trustees to consider the merits of these measures in the context of their own charity.

Part 3: Financial control



The importance of financial control

3.1 Corporate governance focuses on doing business in a proper manner. But it is equally important for trustees to ensure that the resources of the charity are managed securely and economically and deployed to the best advantage of users and beneficiaries. This involves having effective systems of financial control, which are essential to ensure that business is conducted in accordance with the law and to minimise the risk of a breach of trust. In this way, public confidence in the charity is maintained. The importance of financial control is reflected in Chapter 3, paragraph 25 of the Charity Commission's publication 'NHS Charitable Funds: a Guide' which states as a legal requirement that "Trustees have the general duty of protecting all the charity's property. In particular they:

- are accountable for the solvency and continuing effectiveness of the charity and the preservation of its endowments;
- must exercise overall control over its financial affairs;
- should ensure that the way in which the charity is administered is not open to abuse by unscrupulous associates or employees; and
- should ensure that their systems of control are rigorous and constantly maintained."

3.2 The size of charitable funds associated with the NHS ranges from a few thousand to hundreds of millions of pounds. In addition, there can be significant variations between trustee bodies in the number and complexity of transactions entered into each year. Consequently, the operating practices and procedures required by different charities vary considerably. Whatever procedures they choose to put in place, trustees will need to strike a balance between the resources needed to maintain high standards of management and control and the risk of cutting administration below the level needed to manage the charity properly. Against that background, not all the elements of good practice noted in this chapter will be helpful to every trustee body but the key principles noted above should be adhered to in all cases.

3.3 This section of the report considers the various measures that trustees have introduced to ensure that robust financial controls are in place. Overall we found that at the bodies we visited controls were sufficient to ensure that business was conducted in accordance with the law and minimise the risk of a breach of trust. We identified many examples of good practice, covering a range of activities.

Financial control - good practice

- ✓ reliable financial systems;
- ✓ comprehensive guidance and procedure notes;
- ✓ agreed policies for the use of reserves;
- ✓ forward planning and budgeting;
- ✓ provision of accurate, timely management information to trustees;
- ✓ management of investments;
- ✓ audit arrangements;
- ✓ agreed spending objectives;
- ✓ trustees control all funds within the charity; and
- ✓ control of fund-raising activities.

3.4 We also made a total of 100 recommendations to the 21 bodies visited concerning financial control, that trustees said that they planned to implement. Further details are given at Appendix 6.

Reliable financial systems

3.5 Trustees are under a duty to ensure that the charity keeps proper books and records, that annual reports and accounts are prepared, and that these conform to the requirements of Part VI of the Charities Act 1993.

3.6 At all the bodies visited we found that the trustees had ensured that proper financial accounting systems were in place. At many, computerised accounting packages designed specifically for charity accounts had been introduced, while at others, charitable funds were accounted for through a discrete part of the financial systems of the associated NHS body.

3.7 We found no evidence to suggest that there were fundamental weaknesses in the financial accounting systems of the bodies we visited.

Comprehensive guidance and procedure notes

3.8 Many bodies had in place comprehensive guidance and procedure notes on their financial systems and control arrangements. While the scope of such documents varied, there was some commonality in the areas they covered. These are illustrated in Figure 3.1.

Figure 3.1

Guidance and Procedure Notes - Area of Coverage

Background information on charity	■ General overview of the charity (for example, historical background, details of objects) ■ Charity structure, fund details ■ Key policies (for example, reserves, investment policies) ■ Useful contacts
How to apply for funds	■ Guidance for potential applicants on the procedures to follow to bid for funds ■ Copies of relevant forms
Handling receipts	■ Guidance for staff on how to handle funds received at work ■ Copies of relevant forms
Fundraising	■ General guidance on fundraising ■ Details about the charity's position on fundraising
Financial accounting system	■ Procedure notes/desk instructions for charity administration staff

Source: NAO Analysis

3.9 Once developed, guidance notes need to be subject to regular review and circulated as widely as possible amongst charity and hospital staff. This ensures that guidance remains current, it increases people's awareness of the charity and helps to ensure that they act appropriately at all times. These factors were readily appreciated by the bodies that we visited.

Forward planning and budgeting

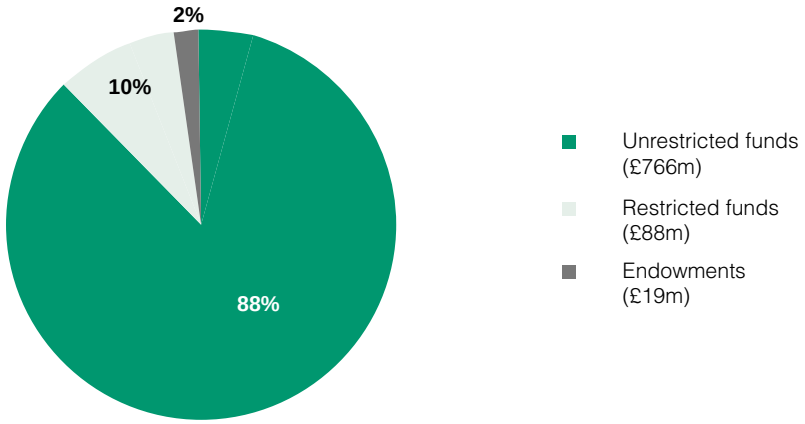
3.10 The Charity Commission, in their publication "Internal Financial Controls for Charities," advise that in order to achieve full control over a charity's finances, it is necessary to work within an agreed budget and undertake full financial planning.

3.11 The various ways in which charitable funds are held (see Figure 3.2) means that there is no one planning and budgeting model for trustees to apply to the utilisation of those funds.

Nature of charitable funds held by the sample of trustee bodies visited

Figure 3.2

Figure 3.2 shows the relative size of fund types held by the sample of trustee bodies visited.



Source: Summarised Account of Funds Held on Trust 1998-99

Note: Figures showing the proportion of designated funds within unrestricted funds are not readily available.

3.12 However, the Charity Commission has recommended that the trustees of all these charities should take certain steps, whatever the size and type of the funds they administer. They are for trustees to:

- work within an agreed budget and to undertake full financial planning;
- prepare proper and realistic estimates of expected income and expenditure for each financial year;
- undertake regular reviews to ensure that the charity's budgets are not stretched beyond their limits;

- approve the budgets and accounts only after discussion at trustee meetings and fully minuted discussions, and

- understand the financial information that is given to them and ensure that full explanations and training are provided for those who are not familiar with financial matters.

3.13 These measures should cover all the funds administered by the trustees, including any significant designated or restricted purpose funds. This reflects the fact that trustees cannot legally delegate their overall responsibility for the funds vested in them.

3.14 Some of the larger bodies we visited had well-developed procedures for planning and budgeting. These were designed to give the trustees assurance that the funds were being used within the objectives of the charity and to help prevent the unplanned growth of fund balances. We noted that decisions on future spending were often taken in conjunction with the long-term plan for the spending of exchequer funds by the associated NHS body. In a typical planning and budgeting cycle, discussions between the trustees and the NHS body would be held to identify the timing and priorities for future spending. Trustees would then consider, on an informed basis, the extent to which they could support these projects in the light of their existing commitments, and prepare plans for future expenditure.

3.15 For example one large body prepares an annual financial strategy to complement their three-year strategic plan. The strategy considers the funds available for expenditure, after making allowances for existing commitments; the proposed contributions to fund future large capital projects; the allocation of funds between broad themes; and the approval of budgets for each area.

3.16 Where lower levels of charitable funds are held, these are less significant to the running of the associated NHS body. Some of these trustee bodies told us they felt that detailed long term planning was unnecessary unless they were fund raising for a specific project.

3.17 Almost half of the bodies we visited did not have formal spending plans that would enable them to monitor progress against planned expenditure. And most bodies preparing budgets limited their scope to unrestricted funds that were available for general purposes. Bodies that maintained a number of funds for particular purposes and held small proportions of their total funds within the

general purpose funds did not usually see the need to prepare budgets or plans. They felt that it was impractical to produce individual budgets for large numbers of separate funds.

Designated funds

3.18 All of the bodies we visited had earmarked a proportion of their unrestricted funds for particular purposes. These are termed "designated funds" and unlike restricted funds the trustees are free to cancel the designation if they later decide that the funds are no longer needed for the intended purpose. We found that designated funds were often used to identify separately income received for wards and medical specialisms. Some examples of designated funds are shown below.

Examples of designated funds

Figure 3.3

Support for a hospital redevelopment project

Funds invested in operational fixed assets, for example, a nurses' home

Research

Source: NAO Analysis

Ward and patient services funds

3.19 The designation of funds can be a useful aid to planning future expenditure. But if the case for designation is not properly assessed, it can significantly restrict the flexibility to spend money in accordance with the charity's aims. In determining whether to designate funds, trustees should consider whether:

- the amount of any funds held as designated funds is appropriate;
- sufficient funds have been retained in a reserve to meet general commitments;
- fund advisors for designated funds should submit plans to the trustees on how they intend to utilise the funds at their disposal, to prevent the unplanned growth in overall charity balances; and
- the balance between short and long term investments is appropriate to meet the potential expenditure requests from fund advisors.

Reserves

3.20 As part of the planning and budgeting process, trustees need to establish a reserves policy. Since 1996 the Charity Commission have recommended that all charities should disclose their policy for managing their reserves in the annual report or a note to the accounts. This is to allow charities to demonstrate that they are not accumulating funds unnecessarily and to help them manage their expenditure.

3.21 The Charity Commission define "reserves" as resources available to the charity after it has met its commitments and covered its other planned expenditure. They recommend that the reserves policy should cover as a minimum:

- the reasons why the charity needs reserves;
- what level (or range) of reserves the trustees believe the charity needs;
- what steps the charity is going to take to establish or maintain reserves at the agreed level (or range); and
- arrangements for monitoring and reviewing the policy.

3.22 Although all the bodies we visited had considered how to meet these recommendations, five of them had not disclosed any policy in their 1997-98 annual report and accounts. Seven had developed reserves policies without having formal planning and budgeting arrangements. An example of what a good reserve policy might look like is shown below.

Example of a good reserves policy

- Free reserves represent resources available to the trustees after they have met their commitments and covered other planned expenditure. At the beginning of each year we plan the finances for the coming three years. Firm commitments are made for expenditure but we can only estimate the income we will receive. We determine a free reserve level to ensure we will meet the spending plans in this period if incoming resources are up to 20 per cent less than expected. If income of unrestricted funds exceeds the money designated for future expenditure we review the balances remaining. Our planned annual expenditure over the next three years is £5.5 million and we require £3 million free reserves in line with our policy

and a further £0.5 million to cover working capital requirements. The actual value of free reserves held at 31 March 2000 was £4 million, comprising £3.5 million of investments at market value with the remaining £0.5 million held in cash, deposits and current assets. We aim to ensure that the actual level of free reserves held on unrestricted funds is in balance with our requirements. We currently hold free reserves of £4 million against a target of £3.5 million. We are reviewing our expenditure plans in the light of this.

There are also free reserves within the restricted funds of £1 million which are readily available for trustees to use for the specific purposes of these funds. These reserves are held in short-term deposits and the trustees endeavour to spend them within two months of receipt. A large number of donations to restricted funds were received towards the end of the year which accounts for the level of the free reserves standing at £1 million at 31 March 2000.

The calculation of these figures is shown below.

	Unrestricted Funds £m	Restricted Funds £m
Total balances at 31 March 2000	15	5
Assets held for charitable purposes (eg operational buildings)	4	-
Designated funds		
■ Nurse Training	2	-
■ New bed scheme	1	1
■ Education	2	1
■ Patient services	2	-
■ New kidney machine	-	2
Free reserves	4	1

3.23 It is important that trustees should be seen to administer their charities in line with the declared reserves' policy. Unless this is achieved, any body associated with the NHS holding significant reserves for charitable purposes could be open to criticism by those it is designed to serve, the community within which it operates and donors, public at large and prospective donors. This is particularly true if the body is running public appeals emphasising the urgency of its own need for donated funds. The risk is that trustees could be seen as self-indulgent, by retaining funds which could be used immediately to support their aims.

3.24 This risk is heightened in the small number of cases we noted where the trustees had classified all of their funds as designated or specific purpose funds and had not prepared a reserves policy. In our view these trustees are misinterpreting the current Charity Commission guidance on reserves policies. Since our examination was conducted the guidance on reserves has been strengthened by additional advice included in the NHS Executive's Funds Held on Trust: 1999-2000 Manual published in January 2000 and in the Charity Commission's Exposure Draft of Accounting and Reporting by Charities: Statement of Recommended Practice published in December 1999.

Criteria for effective planning, budgeting and cash management

3.25 We believe that the main criteria trustees should consider to ensure good planning and budgeting and cash management are as follows:

Planning

- they should allocate clear roles and responsibilities for the drawing up, implementing and review of the plan;
- the plan considers the charity's development over at least three years;
- it takes account of developments in the related NHS body;
- it includes the details of the charity's present context, its strengths and weaknesses, aims and present values;
- there is a clear vision of where the charity should be in the future;
- it takes account of the future context, likely resource availability, and relevant legislation;
- it includes the whole of a charity's activity;
- it incorporates the financial implications, including the current budget and financial projections for the years immediately following the period covered by the plan;

- there is appropriate consultation with staff, trustees and other interested parties;
- it includes the delivery methodology, with specific targets and a timescale for implementation; and
- achievement can be, and is, measured against pre-determined criteria.

Budgeting and cash management

- the budget-setting process is closely aligned to those priorities contained in the plan and takes account of the amounts that trustees may have designated for particular projects or uses;
- ensuring that a realistic view is taken of the market value of investments at the time they will be realised to ensure that charity funds are not over committed;
- there should be a clear reserves policy that meets the Charity Commission's guidelines;
- amendments to the budget and the use of contingencies reflect predetermined options outlined in the strategic plan;
- performance against the budget is closely monitored, with a regular review of income and expenditure against that profiled, and with effective control over budgets; and
- cash balances are identified through knowledge of budget profiles and the timing of payments and invested appropriately.

Provision of accurate and timely information to trustees

3.26 In order to discharge their responsibilities effectively, trustees need relevant management information to inform their decision-making. To be useful management information should be:

- timely;

- relevant;
- usable; and
- accurate

3.27 All trustees were provided with regular information on the administration of the charities. We noted that there were significant differences between bodies in the scope of the information provided. Information was usually included in formal papers submitted to each meeting of the trustees.

3.28 At the most basic level, the information provided to trustees was a report showing expenditure and income to date during the current financial year and the total outturn for the preceding financial year. On its own such a report would make it difficult for trustees to assess whether they have sufficient funds to meet future commitments, or to evaluate whether the balance between long and short term investments is appropriate.

3.29 Some trustees were also provided with a report listing some or all of the charitable funds transactions that had taken place since the start of the financial year or the last trustees' meeting. While potentially useful, some of the reports that we saw at bodies with a large amount of transactions, risked overburdening the trustees with a mass of detailed information that would be hard for them to interpret.

3.30 Other bodies had more sophisticated arrangements that included approved budgets against which expenditure could be monitored. We noted examples where a series of high level reports had been prepared from this information, to enable trustees to easily obtain an overview of the activities of the charity and highlight areas requiring action or further explanation. One body summarised actual expenditure by main headings and also included information on budgets and expenditure commitments. The report also included explanations for significant changes in planned expenditure. Further details of the expenditure contained in each heading was provided in supporting papers.

3.31 We recommend that, as appropriate, the information set out below should be included in reports to trustees.

Information for inclusion in report to trustees

- spend in period;
- total spent to date*;
- comparative figures for the previous financial year*;
- budget for year*;
- list of large or unusual transactions;
- list of significant donations;
- use of chairman's (or other officers') discretionary authority;
- summary investment report; and
- report on slow moving or overdrawn funds

* Broken down to fund or budget heading

Management of investments

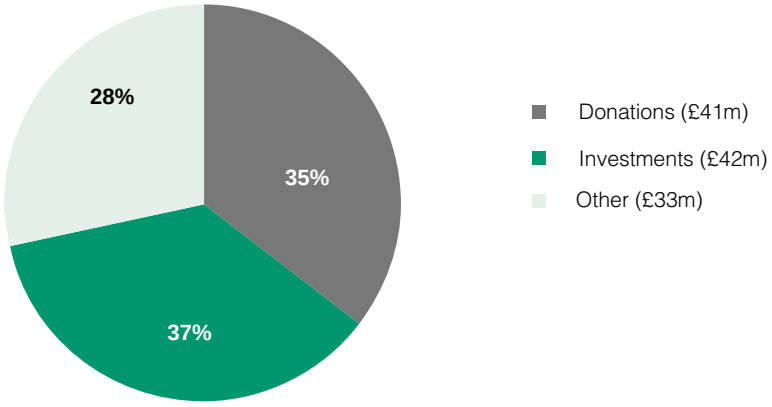
3.32 The trustees of most charities associated with the NHS have the powers of investment set out in their governing document. In the absence of specific powers they rely on powers conferred by the Trustee Investments Act 1961 although this may change if Parliament brings into force proposals within the Trustee Bill which they are currently considering. Trustees are under a duty to decide what forms of investment are the most suitable to satisfy their requirements and should obtain skilled advice for this purpose. The Charity Commission advises that trustees should bear in mind the long-term future of the charity as well as the short-term, and try to counteract the effects of inflation on their capital and income. They should also monitor the performance of their chosen investments.

3.33 During our investigation we found no evidence that trustees' investment activities were contrary to the Charity Commission's guidance. We noted that trustees had invested their funds in a number of ways including cash on deposit, equities, gilts and property. For the trustee bodies we visited, investments income was, by a small margin, the largest source of income as shown in Figure 3.4.

1998-99 Income streams for the sample of trustee bodies visited

Figure 3.4

Figure 3.4 shows that in 1998-99 income for the sample of trustee bodies visited was fairly evenly split between donations, investment income and other sources.



Source: Summarised Account of Funds Held on Trust 1998-99

3.34 Trustees should not expose the charity's assets to undue risk, and should ensure that the charity has an adequate cashflow to meet its continuing commitments. The bodies we visited had performed well in achieving these aims.

3.35 All the bodies had engaged the services of a professional investment manager although only nine had made the appointment after a competitive tender. Some had employed the same investment manager for many years without any formal market testing of alternative suppliers. One body had employed an investment manager on this basis since 1959. We consider that trustees should periodically test the market for all their service providers.

3.36 We found that nine bodies had structured procedures to monitor the relative performance of their investment managers. This task was either performed by one of the trustees who was a professional investment advisor or by employing an external consultant. The remainder either had informal arrangements to monitor the performance of their investment manager or did not have any set procedures at all. We consider that it is good practice for trustees to regularly review the performance of their investment managers.

3.37 A few of the bodies had placed charitable funds in property. Some property holdings were justified as furthering the objects of the charity by improving the environment for patients and staff, for example staff accommodation. Other property portfolios were held solely for investment purposes. However, one body had around ten per cent of its assets held in the form of functional property, but had not recognised this when designating funds and there was a risk of the trustees overestimating the amount of free funds available to spend. In planning their activities trustees need to recognise that funds tied up in property may not be realisable quickly, and are not available for other purposes.

3.38 The Trustees must manage the charity's money so that funds are available to cover outgoings, while income is maximised, and expenses minimised. Funds should also be safeguarded as far as possible against the risk of loss. As good practice trustees should:

- ensure that they approve the charity's investment policies and procedures;
- draw up and regularly review an approved list of bodies with whom they are prepared to invest;
- set an investment strategy which emphasises the importance of ensuring that cash is available when needed, and meets the terms of their investment powers;
- set individual limits on the amounts to be invested with each body on the authorised list based on the assessment of credit rating and standing;
- operate adequate financial controls over investment activities which are regularly reviewed by internal audit; and
- receive, and regularly review, reports on the performance of their investments.

Internal audit arrangements

3.39 Every trustee body we visited had internal audit arrangements in place or were in the process of appointing internal auditors. For *corporate trustees* the internal audit function for the associated NHS body usually covered the charitable funds as well. Some *special trustees* had appointed separate internal auditors; others had utilised the internal auditors from the associated NHS Trust.

3.40 Generally the internal audit arrangements appeared to be working effectively. However, at two of the *special trustees*, internal audit reports were being presented to the NHS Trust rather than the trustees. We consider that when internal and external auditors report on matters dealing with the operation of the charitable funds, they should be required to make those reports to the charity's trustees. This recognises the distinct legal status of the charity and would provide the trustees with an opportunity to consider the auditors' findings and the implications for the charity. In both the cases referred to above, the *special trustees* have agreed to implement our recommendations.

Agreed spending objectives

3.41 It is a requirement of trust law that trustees must only spend funds for the purposes set out in the charity's governing document and for no other purposes. However, they should not use their resources to do what is already being done by statutory services financed out of rates or taxes, but they may supplement those services by providing additional services beyond the statutory provision. The governing documents of charities associated with NHS bodies give trustees wide discretion on how they can spend their funds. Many trustees took the view that charitable funds should be used if public funding was not available within a reasonable period.

3.42 Overall we found that trustees had addressed the issue of how to use funds to further the aims of their charities in a responsible and appropriate manner. We checked a sample of payments from the charitable funds to see whether they had been made for the purposes set out in the governing documents. We found no examples of payments for inappropriate or irregular purposes but we did raise some questions on the nature of some income streams from which payments were subsequently made. These issues are described more fully in paragraphs 3.47 to 3.49.

3.43 We noted instances where trustees had turned down requests for funding that they considered were clearly not charitable, indicating that their financial controls were operating effectively. For example, one trustee body had refused to fund mandatory courses for hospital staff that should be paid for from public funds.

3.44 Some of the bodies we visited had developed specific guidance on what type of bids for charitable funds would be acceptable, and had issued these to fund advisors and to potential grant applicants. We would encourage trustees to develop similar guidelines appropriate to their own needs as illustrated below.

Example of guidance issued to grant applicants and fund advisors

- all requests for expenditure should meet the broad criteria of:

  (a) falling within the objects of the charity,

  (b) not normally funded by the exchequer, and/or

  (c) no exchequer funds are available (in this case, funding should be short term and reviewed regularly);

- funds should be used to provide additional amenities which improve conditions for patients and/or the conditions under which staff work;

- any funding for staff contracts should not be for more than two years;

- where funded posts relate to service delivery there should be a clear written commitment from the purchaser to pick up funding at the end of the programme;

- funding requests should identify all revenue consequences; and

- staff funds are to be spent in a reasonable period.

Trustees control all funds within the charity

3.45 As described in Part 2, the trustees are responsible for the administration of all funds held by the charity, even when they are held in designated funds or special trusts. We noted many cases where individual funds within the trustee body had been set up at the request of individuals to hold income generated as a result of their work, for example medical consultants and ward funds. The types of income we saw included:

- donations received from relatives and patients;
- income received as a result of conducting clinical trials for research purposes and treating private patients; and
- regular income from the charity's investments and any unrealised gains on the investments.

3.46 In practice when donations are given for a specific and narrow purpose, the trustees may find difficulty in utilising the funds as intended. For example one body had received a number of charitable donations to support a cancer unit, but the trustees had experienced difficulty in identifying suitable projects for funding as the unit was fully resourced. As a result the fund balance has increased by 50 per cent in the last two years. In such cases, we recommend that trustees consult with the Charity Commission to explore the possibility of easing the restrictions on the funds.

3.47 As part of their financial control procedures, all the bodies we visited had issued guidance on the recognition of income. Although some bodies had included clear instructions we found that others were unsure about how to handle certain forms of income. For example, difficulties arose when trustees were unsure about the basis on which money was held, whether there were any special trusts attached to the money and who controlled it. There were also difficulties about whether charitable funds had been used for a charitable purpose or for a trading activity and what the tax implications of that might be.

3.48 The main issues concerning trustees arose from:

- private patient fees donated by consultants;
- lecture fees donated by hospital staff;

- funding of research through commercial bodies; and

- trading activities.

3.49 Consultants and hospital staff may donate money which they receive as fees for giving lectures or from their private patients but they must normally pay any tax due before the donation is made. The trustees will be able to reclaim basic rate tax if the donation is made through a tax efficient form such as covenant or gift aid. In some cases donors restrict the use of the donation to particular limited purposes relating to their area of work. In these cases the trustees must decide whether to accept the donation. If the donation is accepted decisions about how it is to be spent are the responsibility of the trustees and not the donor.

3.50 Some bodies were unclear about their position in relation to research. This can cause difficulties because charitable resources might be used in research in several ways and income arising from research must be properly accounted for. The following issues need to be considered:

- if the research is paid from charitable funds the trustees must be sure that they have the power to do so, that the research they are funding is charitable and that the useful results of research are made available for the benefit of the public. When charitable funds are being used in this way the trustees must scrutinise any agreements to ensure that they are suitable for them to fund and that any income received is adequate recompense for the use of charitable resources;

- if a member of the hospital staff or a consultant receives payment for their research work which they intend to donate to a charity then the trustees should treat it as other donations as described in paragraph 3.49; and

- if the research is carried out by a commercial company but using resources belonging to the NHS Trust the agreement between the researcher and the NHS Trust should determine how the NHS recovers any costs. Such monies will be attributable to exchequer funds and not the charitable funds.

3.51 Trustees need to take care when they are engaged directly in trading activities whether it is a trade carried on as part of the primary purpose of the charity or one which is designed to raise funds for the charity. Liability for tax will

depend on the type and extent of trading activities which the charity engages. We recommend that trustee bodies should seek professional advice in cases of uncertainty.

Control of fund-raising activities

3.52 The Charity Commission's guidance is that when fund-raising the trustees should always:

- insist on approving the fund-raising methods adopted and any appeal literature used on their behalf;
- make sure that any appeal properly describes what donations from the public will be used for;
- be prepared to be open and honest about the costs of the appeal; and
- ensure that where professional fund-raisers are employed as agents for the charity, a proper contract is drawn up.

3.53 A small number of the trustee bodies were actively engaged in large-scale charitable fundraising activities. We found that well established fundraising procedures were usually in place. Examples of what the guidelines might include are shown below.

Information that might be included in guidelines for fundraisers

- approval and authorisation procedures;
- co-ordination with other fundraisers;
- legal requirements of the Charities Act 1992;
- professional fundraisers;
- areas of concern such as trading activities, collections, unauthorised fundraising and protection of the charity's image;

- keeping accounts, and
- who to approach for advice.

3.54 The majority of trustees were not actively engaged in charitable fundraising and, as a result, many of them had not developed guidance for their staff. During our investigation we identified limited charitable fundraising in some of these charities, where staff or members of the public had sought to raise money, for example, through holding a summer fete or similar event. While the level of funds involved was low, we believe that the trustees of these charities could have been exposed if, for example, the funds had been misappropriated.

3.55 We believe it is in the interests of all NHS bodies, engaged in charitable fundraising, or allowing their premises to be used for charitable fund raising, to produce guidelines, based on existing Charity Commission guidance, for circulation amongst staff, patients etc. This would help to ensure that any fundraising takes place in a controlled and regulated way.

Part 4: Supervision and accountability of charities associated with the NHS

Current arrangements

4.1 This part of the report sets out our findings and conclusions on whether the current arrangements for the supervision and accountability of charitable funds associated with the NHS are satisfactory.

4.2 Both the Charity Commission and the NHS Executive (acting on behalf of the Secretary of State) have responsibilities connected with the supervision and accountability of charitable funds associated with the NHS. These are summarised in Figure 4.1, and set out in detail at Appendix 2.

Figure 4.1

Responsibilities for Supervision and Accountability of Charities Associated with the NHS

	Features of Supervision & Accountability	Secretary of State/ NHS Executive	Charity Commission
1	Appointment and removal of trustees and the determination of their terms of office.	Yes	Yes *Limited and not normally exercised because of the Secretary of State's powers*
2	Promoting the effective use of charitable resources, monitoring the activities of trustee bodies and providing guidance.	*Provision of guidance and monitoring, limited to accounts matters*	Yes
3	Powers to institute inquiries of charities.	No	Yes
4	Transfer of property between charities.	Yes	No
5	Production of annual accounts.	Yes	Yes
6	Audit requirements.	No	Yes

Source: NAO analysis (Appendix 2)

Appointment and removal of trustees and determination of their terms of office

4.3 The Secretary of State for Health has powers under various NHS Acts to appoint and remove trustees of charities associated with the NHS and to determine their terms of office. In exercising these powers, the NHS Executive appoints individual special trustees, and also the chairmen and non-executive directors to the boards of NHS bodies that may act as corporate trustee for charitable funds. These appointments have recently been brought into line with the recommendations of the Committee on Standards in Public Life and are now publicly advertised, open to competition and involve independent scrutiny. Although trustee appointments do not fall under the jurisdiction of the Commissioner for Public Appointments, the NHS Executive does seek to follow the Commissioner's guidance. At least two posts on each trustee body are reserved for a non-executive nominee from the host health authority and NHS Trust. As NHS non-executives they have been through a formal selection process involving independent scrutiny. In our view the NHS Executive's arrangement should help to:

- ensure that charitable funds are deployed in accordance with local health needs whilst ensuring compliance with donors' wishes;
- by following standards in public life, reduce the risk of trustees becoming self-perpetuating oligarchies, by publicly advertising appointments and making them open to competition; and
- secure as trustees a proper cross-section of the local community with appropriate skills.

4.4 The NHS Executive has never been required to invoke their powers to remove any trustee of the charitable funds.

4.5 In very limited circumstances the Charity Commission has powers under the Charities Act 1993 to appoint or remove trustees. These powers extend to the appointment of a new trustee body in place of a NHS Trust, Health Authority or a body of special trustees. They cannot be used to replace individual members of a NHS Trust or Health Authority, or individual special trustees. However, in practice the Secretary of State routinely appoints trustees to charitable funds associated with the NHS.

Promoting the effective use of charitable resources

4.6 Each year the NHS Executive issue to trustee bodies a "Manual for Accounts", setting out their requirements for the preparation and submission of accounts forming the basis of the Summarised Account of Funds Held on Trust. The Manual is prepared in consultation with the Charity Commission and read in conjunction with the Charities Statement Of Recommended Practice provides a reference for the preparation of the accounts of Funds Held on Trust. Apart from this, the Executive does not issue guidance directly to the trustee bodies. However during our investigation we found that guidance and circulars that they have issued to NHS bodies, for example, recommendations on good practice in corporate governance, had been adopted by corporate trustees. The NHS Executive's monitoring of charities associated with the NHS is restricted to issues arising from the preparation of accounts.

4.7 The Charity Commission plays an important role in promoting the effective use of charitable resources. A pilot study undertaken by the Commission in 1993 indicated that there might be up to 25,000 charities associated with the NHS that needed to register, and that there could be a further 25,000 that did not meet the minimum requirements for registration. Many of these charities had only informal trusts and no governing documents. The pilot clearly identified a need for rationalisation and consolidation if the charities were to meet the tighter reporting and accounting arrangements that came into force in 1996.

4.8 Working with trustees, the Commission used its statutory powers so that there is now a single main (or "umbrella") charity for each of the NHS bodies involved in the management of charities, with a relatively small number of subsidiary charities. This work was substantially completed by 1996. The Commission has continued to work to ensure that this pattern remains the case especially as NHS bodies merge or are created.

4.9 In parallel with this rationalisation the Commission has produced special guidance for NHS bodies on the duties, responsibilities and obligations which charity law imposes on NHS bodies in their capacity as charity trustee. This is called "NHS Charitable Funds: A Guide", otherwise known as the "Blue Book" and was published in 1994. In line with comments from a number of bodies visited, we consider that a review of how best to provide this guidance, while ensuring its continued relevance and currency would be appropriate and welcome.

4.10 NHS charities with a gross income or total expenditure over a certain amount are covered by the Commission's computerised monitoring procedures. Trustees are required to complete an annual return based on a number of specific questions. The data is entered onto the Commission's computer system. Some of the answers to the questions form a trigger which prompts the Commission to make further checks. For example, if the return indicates that a trustee has received a substantial sum for professional services, the Commission will check that the charity has the power to pay a trustee for such services and that the level of payment is appropriate to the duties performed.

4.11 During our visits, a number of bodies suggested that further guidance on certain issues, for example, reserve policies and the treatment of research funds, would be helpful. Since our examination was conducted the guidance on reserves has been strengthened by additional advice included in the NHS Executive's Funds Held on Trust: 1999-2000 Manual published in January 2000 and in the Charity Commission's Exposure Draft of Accounting and Reporting by Charities: Statement of Recommended Practice published in December 1999.

Powers to institute inquiries of charities

4.12 The Charities Act 1993 empowers the Charity Commission to institute inquiries of charities either generally or for specific purposes. The NHS Executive has no such powers. If satisfied that misconduct or mismanagement has occurred the Commission can suspend any relevant trustee, freeze bank accounts and appoint a receiver and manager. The Commission informs the NHS Executive when deciding whether to instigate an inquiry and also provides them with the results if an inquiry does go ahead, but the NHS Executive does not take part in the enquiry itself.

4.13 For the last two years the Commission's accountancy staff have examined 70 or 80 accounts of charities associated with the NHS with an income of over £1 million. This has helped to clarify areas of concern which have then been addressed in the "Manual for Accounts" issued annually by the NHS Executive (paragraph 4.6). From the Commission's monitoring of the 1997-98 accounts of charities associated with the NHS, 169 issues were identified which were subsequently discussed with the trustees. The most common concerns were clarification of ownership of property, the absence of a proper reserves policy, and the need for further information relating to expenditure on research to confirm that it was charitable in nature. With one exception, which remains under review, the difficulties were resolved by discussion and did not require further investigation. Figure 4.2 provides further details of the issues raised with trustees by the Charity Commission.

Charity Commission breakdown of subject areas of issues arising from the scrutiny of the accounts of charities with income in excess of £1 million in 1997-98

Figure 4.2

Figure 4.2 shows that the main issues raised by the Charity Commission with trustee bodies related to property ownership, reserves and research activities.

49	Clarification that the property accounted for corresponded with that of the charities registered
33	Reserves
23	Research
20	Incomplete notes to the accounts
11	Trading
5	Pooling of investments
5	Classification of cash and short-term investments
5	Fund-raising costs
4	Missing costs (such as costs of audit)
4	Trustees' Annual Report missing
3	Voluntary income qualifications
3	Classification of funds
2	Notes which did not relate to the accounts
2	Expenditure of endowment

Source: The Charity Commission

4.14 The Commission investigate allegations or other evidence of misuse and misapplication of charity property. In 1997-98 the Commission undertook two investigations of charities associated with the NHS. One of these was an evaluation of a speculative fund-raising venture supported by funds from the charity. In this instance the venture raised further funds for the charity but in setting it up, charitable money was at risk. The Commission advised the trustees about better governance procedures which would have prevented funds being put at risk. The trustees accepted the advice and changed their procedures. The Commission continues to monitor the charity. The second investigation, which is still in progress, concerns a number of issues including conflicts of interest and the high level of support given to associated trading companies.

Transfer of property between charities

4.15 Under s92 (1) of the NHS Act 1977 the Secretary of State has the power to transfer charitable funds between trustees. This power was used to disperse the majority of funds held by health authorities to the new NHS trusts established under the NHS Act 1990. An important positive aspect of the Secretary of State's powers to transfer property between trustees, is that it helps to ensure that any changes in the structure of NHS Trusts and health authorities are mirrored in the associated charitable funds.

Production of annual accounts

4.16 Under Section 98 of the National Health Service Act 1977 the Secretary of State for Health is required to prepare annually a Summarised Account of the Funds Held on Trust. The Chief Executive of the NHS, as Accounting Officer, signs the Summarised Account. His responsibilities are to:

- aggregate the accounts of the individual charities and ensure that the resultant Summarised Account is fairly presented;
- ensure that proper financial procedures are followed in the preparation of the Account and that proper accounting records are maintained to support the Account;
- be a witness before the Committee of Public Accounts and deal with questions arising from the Account relevant to his responsibilities; and
- issue directions as to the format of the accounts of the individual charities for inclusion in the Summarised Account.

4.17 Trustees are required, under the NHS Acts, to submit audited accounts to the NHS Executive for inclusion in the Summarised Account of Funds Held on Trust. Trustees are required to submit these accounts together with any report or management letter prepared by their auditors by 31 August. The Executive review these submissions and bring any significant issues to the attention of the Charity Commission.

4.18 The Summarised Account does not give a complete picture of charitable funds associated with the NHS, because it does not include the transactions and balances of the many charities outside the scope of the NHS Acts, that raise and hold funds to support the NHS (see paragraph 1.15).

4.19 Under the Charities Act 1993, trustees of charities with gross income or total expenditure over £10,000 are also required to submit annual accounts to the Charity Commission. The NHS Executive has worked closely with the Commission, to ensure that accounts submitted to both organisations are virtually identical and do not impose significant additional burdens on the trustee bodies concerned, except for the smallest charities which otherwise would not need to submit annual accounts.

Audit requirements

4.20 Subject to exemption criteria based on the size of annual income, the Charities Act 1993 requires a charity's annual accounts to be independently examined or audited before submission to the Charity Commission. Audited accounts must be submitted to the Commission within ten months of the charity's financial year-end. Audited accounts should be submitted to the NHS Executive by 31 August, that is, within five months of the financial year-end. Under the NHS Act 1977 all accounts must be audited by auditors appointed by the Audit Commission. The Charity Commission currently accepts the scrutiny of these accounts by auditors appointed by the Audit Commission, as meeting the auditing requirements of the Charities Act 1993, thereby avoiding any duplication of audit work.

4.21 The Comptroller and Auditor General audits the Summarised Account of Funds Held on Trust and reports to Parliament. By virtue of the NHS Act 1977 he has access to the records of each charitable fund included in the summarised account. The Comptroller and Auditor General is also the external auditor of the Charity Commission.

Appendix 1

History of Funds Held on Trust

- The significant level of funds that constitutes the funds held on trust is, to a large degree, a consequence of the historical funding of early health services in England through charitable sources. Latterly these funds have been boosted through capital growth and income from investments, legacies and donations and fundraising appeals.

- The historical reliance on charitable funds caused health service funding to be unreliable and led to a concentration of services in wealthier areas. These factors, together with a growing perception that it was morally unacceptable for hospitals to be dependent on charitable income, were driving forces behind the creation of the NHS. The inception of the NHS saw the pooling of existing charitable assets into the Hospital Endowments Fund. The main exceptions to this were teaching and university hospitals that retained control of their endowments through Boards of Governors and Management Committees respectively.

- The funds held by many teaching and university hospitals were subsequently put under the administration of *special trustees* appointed by the Secretary of State for Health under sections 24 and 29 of the NHS Reorganisation Act 1973. The 1973 Act (later amended by the 1977 NHS Act) also transferred charitable assets not under the control of teaching and university hospitals (that is, assets in the Hospital Endowments Fund and assets held by Regional Hospital Boards and Hospital Management Committees) to Regional Health Authorities and Area Health Authorities. District Health Authorities superseded Area Health Authorities in 1981.

- The NHS and Community Care Act 1990 created NHS Trusts and provided for them to be able to accept charitable assets held by other NHS trustees. This legislative change created the present administrative position with charitable funds being held by s*pecial trustees*, NHS Trusts (acting as *corporate trustees*), Health Authorities (*corporate trustees*) and Special Health Authorities (*corporate trustees*).

Appendix 2

Statement of responsibilities and accountabilities

1. Background

1.1 Charitable funds associated with NHS bodies may be held by the following:

***Special trustees*:** Under the 1973 NHS Reorganisation Act, funds held historically by many teaching and university hospitals were put under the control of *special trustees* appointed by the Secretary of State for Health. The terms on which *special trustees* hold that property are prescribed by section 93 and 95 of the NHS Act 1977.

Corporate trustees: All other charitable funds in the NHS are managed by *corporate trustees*, ie NHS Trusts, Health Authorities and Special Health Authorities. The Board of the Trust or Authority, and possibly other persons, act as the corporate trustee in the administration of these funds.

Section 11 trustees: Under s11 of the NHS and Community Care Act 1990, the Secretary of State for Health can appoint trustees to hold and administer the charitable funds associated with a NHS trust. At present, there are no section 11 trustees.

1.2 Trustees, the NHS Executive acting on behalf of the Secretary of State for Health and the Charity Commission all have powers and responsibilities with regard to the charitable funds. The responsibilities of each body and their practical implications are summarised below.

2. Trustees

2.1 Trustees are responsible in accordance with trust and charity law for the administration of their charities. *Special trustees* may only delegate their powers or duties to the extent authorised by the terms of the trust or the law relating to trusts and charities, and save for certain specific exemptions, are jointly and severally liable for losses to the trust fund which result from breach of trust.

Practical implications

2.2 The overarching principles of trusteeship (common to all charities) are set out in 'CC3 – Responsibilities of Charity Trustees' published by the Charity Commission, which summarises the legal requirements. The main principles are:

- trustees are required to ensure that the income and property of the charity is applied for the purposes set out in the governing document and for no other purpose;
- trustees should not allow the charity's income to accumulate unless they have a specific future use for it in mind;
- trustees must act reasonably and prudently in all matters relating to the charity and must always bear in mind the interests of the charity;
- decisions affecting the charity should always be taken collectively by trustees;
- trustees must protect charity property and ensure that systems of control are rigorous and constantly maintained;
- trustees are responsible for ensuring that annual accounts and returns are completed and submitted to the Secretary of State and Charity Commission as required; and
- trustees are accountable in law for their actions and may be required to make good any loss arising to the charity if they are judged to have committed a breach of trust.

3. Secretary of State for Health/NHS Executive

3.1 Since 1948 the Secretary of State for Health has been responsible for bringing forward legislation on the appointment and removal of trustees; the terms of their office; the transfer of property between trustee bodies; and the preparation and audit of accounts for the charitable funds. The responsibilities and powers of the Secretary of State in respect of the charitable funds are exercised through the NHS Executive. The main responsibilities are:

3.2 Accounting and Audit Requirements

3.2.1 Under s98 (4) of the NHS Act 1977 the Secretary of State must prepare the Summarised Account of Funds Held on Trust. The Chief Executive of the NHS as Accounting Officer signs the Account. His relevant responsibilities are set out in the Accounting Officers' memorandum issued by the Treasury and published in "Government Accounting". The Account is transmitted on or before 30 November to the Comptroller and Auditor General who examines and certifies it, and lays a copy of it together with his report before both Houses of Parliament.

3.2.2 Under s98 (1) and 98(2) of the NHS Act 1977 the Secretary of State can determine the format of accounts to be prepared by individual funds for inclusion in the Summarised Account.

Practical Implications

3.2.3 In practice, the Accounting Officer's responsibilities in relation to the Summarised Account are:

- to summarise the accounts of the charitable funds and sign the resulting Account and accept personal responsibility for its fair presentation;
- to ensure that proper financial procedures are followed in the preparation of the Account and that proper accounting records are maintained to support the Account;
- to be a witness before the Committee of Public Accounts and to deal with questions arising from the Account relevant to his responsibilities; and
- to issue directions as to the format of the accounts of the charitable funds.

In addition, the Accounting Officer, acting on behalf of the Secretary of State, should make administrative arrangements for the appointment of *special trustees* and trustees for NHS Trusts; and the transfer of property between NHS trustees.

3.2.4 The Accounting Officer is not responsible for the decisions of corporate or other trustees, or their arrangements for administering the funds that they hold on trust. It is the responsibility of the trustees of individual charities to ensure that funds are properly and well managed and that assets are controlled and safeguarded (see paragraph 2).

3.2.5 The NHS Executive sets out their requirements for preparation and submission of the accounts of individual funds in the Manual for Accounts. Trustees are required to supply the NHS Executive with a copy of their annual audited accounts. The NHS Executive then prepare an account summarising the balances of NHS funds held on trust.

3.2.6 Auditors of the accounts of individual funds are appointed by the Audit Commission. Audits are carried out in accordance with Part 1 of the National Health Service and Community Care Act 1990 and a Code of Audit Practice issued by the Audit Commission which requires compliance with Auditing Standards. Auditors are required to form an opinion on whether the financial statements give a true and fair view of the charitable funds and of the incoming resource and application of resources.

3.2.7 The accounts which are prepared by NHS charities under the National Health Service Act 1977 are in the same form as those prepared for the purposes of Part VI of the Charities Act 1993. The Charity Commission dispense with the requirement for an audit under the Charities Act 1993 on the basis that they are satisfied that there is a statutory requirement for an audit of the accounts prepared under the 1977 Act (see section 20 of the National Health Service and Community Care Act 1990) and that the requirements of such an audit are sufficiently similar to the requirements under the Charities Act 1993.

3.2.8 The NHS Executive also review and monitor issues raised in audit reports by the external auditors of charitable funds. They routinely identify audit qualifications which impact upon the Summarised Account and follow up issues relating to their area of accountability.

3.3 Appointment of Trustees

3.3.1 Under s95 (1) of the NHS Act 1977 and s29 of the NHS Reorganisation Act 1973, the Secretary of State has the power to appoint *special trustees*.

3.3.2 Under s95 (4) of the NHS act 1977, the Secretary of State can remove trustees and set their terms of office.

3.3.3 Under s11 of the NHS and Community Care Act 1990, the Secretary of State can appoint trustees to hold and administer the charitable funds for an NHS Trust.

3.3.4 The Secretary of State appoints all the chairmen of NHS Trusts and Health Authorities and the non-executive directors, who act collectively as a corporate trustee for the administration of funds held by NHS Trust and Health Authority charities.

Practical Implications

3.3.5 The Secretary of State routinely uses his powers to appoint trustees based on advice from the NHS Executive. They usually consult the existing trustees and seek the views of NHS regional offices before making an appointment. The NHS Executive have introduced revised procedures for appointing trustees to implement the recommendations of the Nolan Committee.

3.3.6 When NHS Trusts merge, the new body takes on responsibility as corporate trustee for all the funds. *Special trustees* are appointed for a particular hospital and changes to the NHS Trusts which manage the hospitals do not automatically lead to changes in arrangements for the administration of charitable funds by the *special trustees*. The NHS Executive has no powers to reconfigure the *special trustees*. Before charities can merge, approval must be sought from the Charity Commission.

3.3.7 Although the Secretary of State has the power to appoint separate trustees under Section 11 of the NHS and Community Care Act 1990, this power has not been exercised.

3.4 Transfer of Property

3.4.1 Under s92 (1) of the NHS Act 1977 the Secretary of State has the power (having regard to changes in NHS arrangements) to transfer trust property between *special trustees*, NHS Trusts, Health Authorities and Trustees for NHS Trusts. Sections 92(2) and (6) of the NHS Act 1977 enable the Secretary

of State to transfer trust property to or from *special trustees* and section 11 trustees, whether or not there has been any change in arrangements for the administration of any NHS body.

Practical Implications

3.4.2 The majority of charitable funds held by health authorities were dispersed to NHS Trusts under the 1990 Act, following consultation with the Health Authority and local bodies on how the fund balances should be divided.

4. Charity Commission

Since 1960, when the Charity Commission was established in its present form, it has been responsible for regulating the proper conduct and administration of charities. The key responsibilities and powers of the Charity Commission are set out in the Charities Act 1993. The Commission's publication 'CC2 – Charities and the Charity Commission' clarifies how these duties are carried out in practice.

4.1 Registration

4.1.1 Under s3 (1) of the Charities Act 1993 the Commission is required to keep a register of charities not specifically exempted or excepted by s3 (5). Under s3 (7) it is the duty of the trustees of any charity that is required to be registered to apply for that charity to be registered, and for the trustees of any registered institution to notify the Commission if it ceases to exist, or if there is any change in its trusts, or in the particulars of it entered on the register.

Practical Implications

4.1.2 The Charity Commission maintain a central register of charities which is open to inspection by the public. Procedures for NHS charities are no different from other charities although there is a separate section within the Commission dealing with their affairs.

4.2 Appointment of Trustees

4.2.1 The Commission has the power under s16 (8) to discharge a trustee at his request. Otherwise it can only appoint, discharge or remove a trustee under s16 (1)(b) at the charity's request, where there is a court order, the Attorney General is involved, or on the application of a person interested in

the charity if the charity's total income is less than £500 a year. It also has protective powers under s18 to appoint and remove trustees. The Commission's powers can only be used if specific conditions set out in the Act are satisfied.

4.2.2 The Commission's powers to appoint or remove trustees cover the appointment of a new trustee in place of an NHS Trust, Health Authority or a body of *special trustees*. They cannot be used to replace the agent of a non-charitable legal entity which is acting as trustee of a charity. They cannot therefore be used to replace the directors of an NHS Trustee or Health Authority or individual *special trustees*, or other agents of these entities. This is a matter for the Secretary of State and NHS Executive.

Practical Implications

4.2.3 In practice the Secretary of State routinely appoints all individuals to *special trustees*.

4.3 Accounts and Monitoring

4.3.1 S45 (3) (a) and s48 (2) of the Charities Act 1993 respectively require the trustees of each registered charity to send an annual report (and accounts) and an annual return to the Commission for each year when the charity has a gross income or total expenditure in excess of £10,000. Under s42 and 43 of the Charities Act 1993, the Commissioners require that a statement of accounts be drawn up annually by each charity, which complies with SI 1995/2724. The account may need to be independently examined or audited depending on the charity's size.

Practical Implications

4.3.2 If the charity has a gross income or total expenditure in excess of £10,000, the trustees must submit an annual return and submit their annual report and accounts for that year within 10 months of the charity's financial year-end. For NHS charities, this means that the information is due by 31 January. The Charity Commission issue guidance to trustees on the format of the accounts and on auditing requirements. The Commission has issued guidance on how charity accounts can meet the requirements of the Regulations and of the Statement of Recommended Practice for Charity Accounts. S43 of the Charities Act allows exemptions from audit and/or independent examination for small charities.

4.3.3 However, the NHS legislation requires each health body to prepare accounts for the NHS Executive to summarise. They must all be prepared on an accruals basis in accordance with directions given by the NHS Executive and subject to audit. These accounts are virtually identical to accounts required by the Charity Commission. Trustees administering smaller funds are free to prepare accounts just for the Charity Commission on a simplified basis and take advantage of the audit exemptions. However, the NHS Executive have pointed out to trustees that the most economical route would normally be for them to produce accounts to both bodies on the same basis, using the same auditors, although the decision rests with trustees.

4.3.4 The Charity Commission will follow up an adverse audit report which related to matters primarily within the ambit of its responsibilities, and where appropriate could use its protective powers as described in section 4.4.

4.4 Protective Powers

4.4.1 Under s8 (1) of the Charities Act 1993 the Commissioners may institute inquiries of charities either generally or for specific purposes.

4.4.2 If after an inquiry has been instituted under Section 8, the Commission is satisfied that there is misconduct or mismanagement in the administration of a charity and/or that it is necessary or desirable to act for the purpose of protecting the property of the charity then s18 (1) of the Charities Act 1993 authorises the Commission to suspend or remove any relevant trustee, freeze bank accounts and otherwise restrict the charity's transactions, and appoint a Receiver and Manager.

4.4.3 Under s29 of the Charities Act 1993 a trustee may write to the Commission for its opinion or advice on matters relating to the trustee's duties. If trustees believe a proposed action (which may or may not be within their powers) to be expedient in the interests of the charity, they may apply to the Commission for an order under section 26 of the Act to sanction it.

Practical Implications

4.4.4 The Commission's powers are limited to the charity and its trustees. They do not extend to the inner workings of a corporate trustee which is not itself a charity. Similarly, for charities administered by *special trustees*, the

Commission cannot remove an individual from the office of being a *special trustee*. The Commission could, in an appropriate case, remove the complete body of *special trustees* and appoint new trustees in its place.

4.4.5 The Commission informs the NHS Executive when evaluating whether or not to undertake an inquiry. The NHS Executive are informed of the results of any evaluation or enquiry. However, they do not take part in the inquiry itself.

Appendix 3

Charity Commission guidance

The Charity Commission produce a range of publications, which provide information about their role, recommended best practice, the duties of charity trustees, and charity law. Those with relevance to charities associated with the NHS are listed below, with appropriate reference numbers.

Publications		Version
CC2	Charities and the Charity Commission	6/99
CC3	Responsibilites of Charity Trustees	9/99
CC6	Charities for the Relief of Sickness	7/00
CC7	Ex Gratia Payments by Charities	1/95
CC8	Internal Financial Controls for Charities	7/99
CC9	Political Activities and Campaigning by Charities	9/99
CC11	Remuneration of Charity Trustees	10/99
CC12	Managing Financial Difficulties and Insolvency in Charities	1/00
CC13	The Official Custodian for Charities' Land Holding Service	3/95
CC14	Investment of Charitable Funds: Basic Principles	6/96
CC14(a)	Depositing Charity Cash	8/99
CC19	Charities' Reserves	6/99
CC20	Charities and Fund-raising	6/99
CC21	Starting and Registering a Charity	11/98
CC22	Choosing and Preparing a Governing Document	7/99
CC24	Users on Board: Beneficiaries who become trustees	1/00
CC25	Resolving Charity Disputes - Our Role	1/00
CC28	Disposing of Charity Land	6/96
CC29	Charities and Local Authorities	4/96
CC32	Trustee Investments Act 1961: A Guide	8/99
CC33	Acquiring Land	3/95
CC35	Charities and Trading	5/99
CC36	Making a Scheme	9/99
CC37	Charities and Contracts	10/98
CC38	Expenditure and Replacement of Permanent Endowment	4/94
CC43	Incorporation of Charity Trustees	6/99
CC45	Central Register of Charities: Services Available	11/95
CC47	Inquiries into Charities	2/00
CC48	Charities and Meetings	8/99
CC49	Charities and Insurance	6/96
CC58	Accruals Accounts Pack	7/98
CC60	The Hallmarks of a Well-Run Charity	3/99

continued...

Publications

Also available

GD1	Model Memorandum and Articles of Association for a Charitable Company	4/98
GD2	Model Declaration of Trust for a Charitable Trust	4/98
GD3	Model Constitution for a Charitable Unincorporated Association	4/98

Other Publications

- Accounting by Charities – Statement of Recommended Practice (the Charities SORP)
- NHS Charitiable Funds: A Guide

Appendix 4

Study Methodology

Feasibility

- Discussions with the trustees serving University College Hospitals NHS Trust to identify key issues and areas of potential coverage.

- Meetings with the NHS Executive, Charity Commission and Audit Commission to formulate the scope of the study and identify respective roles, responsibilities and accountabilities.

- Legal advice to confirm the nature of the access rights of the National Audit Office to charities associated with the NHS.

- Preparation of paper setting out the roles and responsibilities of the Secretary of State for Health, the Charity Commission and the National Audit Office in respect of funds held on trust, (see Appendix 2).

- Compilation of a questionnaire/checklist for use at charities to ensure comprehensive and consistent coverage during visits.

- Preliminary visits to Luton and Dunstable Hospital NHS Trust and the Special Trustees for St George's Hospital to trial run the audit approach.

- Seminar for representatives of all charities to be visited to discuss the scope and purpose of the study.

Fieldwork

- The bulk of fieldwork consisted of visits to individual charities. A typical visit consisted of two NAO staff being present at the charity for 2 or 3 days. The following key tasks were undertaken:

    - interviews with key finance and administrative staff and trustees as appropriate;

- review of key documentation relating to corporate governance and financial control;
- tests of a sample of transactions by the charity;
- completion of the questionnaire developed during the feasibility study; and
- following each visit an agreed management report was sent to the trustees setting out our findings and recommendations.

How we selected our sample of charities to visit during the main study

- There are over 500 trustee bodies associated with the NHS administering some £1.7 billion of assets. Individual charities have funds held on trust ranging from £1,000 to £256 million. However, the 180 largest charities with funds in excess of £1 million represent over 95 per cent of the total funds held by NHS charities at 31st March 1998.
- Given the spread of holdings across the sector we focussed our examination on the larger charities. This was achieved using a random sample weighted towards larger values. Using this method, larger charities had an increased likelihood of being selected. A further 5 locations were selected judgementally, based on returns from the Audit Commission to the NHS Executive on management letter points, to provide geographical diversity and to ensure coverage of the various types of associated NHS organisation. We did not visit any charities holding less than £1 million. The sample selected enabled us to visit 21 locations collectively holding balances in excess of £800 million and representing about 48 per cent by value of the total funds held on trust. Details of the make up of our sample together with details of individual charities we visited are given below.

Organisation type	Feasibility Study Number visited	Feasibility Study Value of funds 31/3/98	Main Study Number visited	Main Study Value of funds 31/3/98	Total Population Number	Total Population Value of funds 31/3/98
Special Trustee	1	£24m	9	£731m	24	£992m
NHS Trust	1	£10m	10	£100m	400	£700m
Health Authority	0	£0m	1	£3m	100	£28m
Special Health Authority	0	£0m	1	£1m	14	£2m
Totals	2	£34m	21	£835m	540	£1722m

	Location visited	Amount held at 31 March 1998 (£000)
1.	Special Trustees for St Thomas' Hospital	256,863
2.	Special Trustees for St Bartholomew's Hospital	114,000
3.	Special Trustees for Guy's Hospital	111,684
4.	Special Trustees for Great Ormond St. Hospital	93,000
5.	Special Trustees for Royal London Hospital	62,000
6.	Royal Marsden NHS Trust	40,000
7.	Special Trustees for St Mary's Hospital	33,000
8.	Special Trustees for Moorfields Eye Hospital	24,000
9.	Special Trustees for King's College Hospital	20,000
10.	Christie Hospital NHS Trust	19,000
11.	Central Manchester Healthcare NHS Trust	17,000
12.	Addenbrookes NHS Trust	10,000
13.	Special Trustees for Nottingham University Hospital	7,000
14.	Camden & Islington Community Health Services NHS Trust	5,000
15.	Norwich Community Health Partnership NHS Trust	4,000
16.	County Durham HA	3,000
17.	Havering Hospital NHS Trust	2,000
18.	National Blood Authority SHA	1,000
19.	George Eliot Hospital NHS Trust	1,000
20.	Walton Centre for Neurology and Neurosurgery NHS Trust	1,000
21.	Hereford Hospitals NHS Trust	1,000

Expert Panel

An 'Expert Panel' of people from *special trustees*, *corporate trustees*, the National Health Service Executive, the Charity Commission and the Healthcare Financial Management Association was established to review our findings and conclusions and to advise on the practicalities of our recommendations. Panel members contributed as individuals but were invited to take part based on their specialist knowledge of a particular area. We greatly appreciated the contribution made by the Expert Panel. It added valuable focus and context to our work.

Appendix 5

Expert Panel: Members

Royce Batters	Christie Hospital NHS Trust
John Collinson	Secretary to the Special Trustees for Kings College Hospital
Jane Hobson	The Charity Commission
David Parker	NHS Executive
Mike Stepney	Healthcare Financial Management Association
James Varley	Director of Finance; Special Trustees for Guy's Hospital and Special Trustees for St Thomas' Hospital

Appendix 6

Summary of NAO recommendations

	Recommendations to be implemented by trustee bodies
GOVERNANCE	
Trustee oversight	12
Trustees' rules	8
Conflicts of interest	14
Induction of trustees	14
Other	9
Total recommendations made	**57**
FINANCIAL CONTROL	
Guidance procedures	14
Reserves policy	9
Forward planning and budgeting	20
Investments	11
Audit arrangements	6
Queries on specific funds	8
Fundraising	5
Other	27
Total recommendations made	**100**
Overall total recommendations made	**157**

Source: NAO examination at trustee bodies

Glossary

Charitable funds	The financial resources available to the trustees which can only be used to further the objects of the charity.
Exchequer funds	Money voted by Parliament and income received by NHS trusts under contract with purchasers such as GPs and from contracts with commissioners such as health authorities.
Charity trustee	Person who, under the charity's governing document, is responsible for the general control and administration of the charity.
Trustee body	The corporate trustee or special trustees responsible for the administration of the charitable funds associated with an NHS body.
NHS body	A health authority, NHS trust or special health authority.
Reserves	That part of a charity's income funds available for its general purposes.
Restricted funds	Funds subject to specific trusts within the overall objects of the charity.
Unrestricted funds	Funds available to meet any of the overall objects of the charity.
Designated funds	Unrestricted funds earmarked for a particular purpose. Designation does not legally restrict the trustee's discretion to apply the funds for any purpose within the overall objects of the charity.
Umbrella charity	A charity which has been created with purposes wide enough for all other charities administered by its trustees to be registered as special trusts in an umbrella registration arrangement.