



Risk and Proportionality Framework for the Commission's compliance work

July 2008*



*minor updates to terminology made in December 2009

The Charity Commission

The Charity Commission is the independent regulator of charities in England and Wales. Its aim is to provide the best possible regulation of charities in England and Wales in order to increase charities' effectiveness and public confidence and trust. Most charities must register with the Commission, although some special types of charity do not have to register. There are some 190,000 registered charities in England and Wales. In Scotland the framework is different, and the Commission does not regulate Scottish charities.

The Commission provides a wide range of advice and guidance to charities and their trustees, and can often help with problems. Registered charities with a gross annual income or expenditure over £10,000 must provide annual information and accounts to the Commission. The Commission has wide powers to intervene in the affairs of a charity where things have gone wrong.

More information about the Commission together with a range of guidance for charities can be found on our website www.charitycommission.gov.uk, or by contacting Charity Commission Direct:

Telephone: **0845 300 0218**
Typetalk: **0845 300 0219**
By post: **Charity Commission Direct**
PO Box 1227
Liverpool
L69 3UG

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A

Introduction

The Charity Commission is the independent regulator of charities in England and Wales. Our aim is to provide the best possible regulation in order to increase charities' effectiveness and the public's confidence and trust in them.

The Commission's objectives, contained in the Charities Act 2006, are to:

- increase public trust and confidence in charities;
- promote awareness and understanding of public benefit;
- promote trustees' compliance with the law in their control and management of charities;
- promote the effective use of charitable resources; and
- enhance the accountability of charities to donors, beneficiaries and the general public.

The Commission is a risk-based and proportionate regulator. This means that we engage with charities in a way which will make most difference to them and those who benefit from them. Any regulatory action we take will be evidence-based and proportionate, fair and reasonable, taking account of the issue, the risk involved to the charity and its beneficiaries and the capacity of the charity to comply.

Our overall approach to regulation is set out in our publication *The Charity Commission and Regulation*. This framework has not changed. We target our resources where they are most likely to have the greatest impact and we follow the principles of regulatory best practice. We strive to ensure that our actions are proportionate, accountable, consistent, and transparent and only targeted at cases where action is needed.

As a modern regulator, the Commission's overall approach emphasises providing support and guidance and promoting best practice as well as ensuring that charities comply with their legal obligations. We aim to encourage and support charities to improve their performance by working in partnership with them and with sector umbrella groups, to help define and facilitate best practice and share this knowledge widely. We put an emphasis on enabling charities to maximise their impact and on encouraging innovation, effectiveness and collaborative working across the sector.

B

Purpose

We are in the process of refining and strengthening our risk-based approach to regulation. The purpose of this paper is to set out the enhanced approach we are applying in our compliance work. This is shaping the Commission's approach to risk in a critical area.

We carried out an informal public consultation on the risk and proportionality framework between September and November 2007. This paper updates an earlier discussion paper and takes account of public responses to it.

The enhanced approach does not represent a change in policy, but it does introduce a model which publicly shares what we consider to be the areas of greatest risk for charities where we will target our resources. This approach is also reflected in our operational priorities for our compliance work.

This paper focuses primarily on the work of our Compliance function, which is responsible for the delivery of our 'compliance objective' involving regulatory work with charities where their assets, services or beneficiaries are at serious risk of abuse or damage. This includes risks to the reputation of individual charities and, by extension, concerns about public confidence in charities generally and the effective regulation of the sector. The role of the Compliance function is to identify and investigate apparent misconduct or mismanagement in the administration of charities and to resolve difficulties encountered, either by providing support to trustees or, where necessary, intervening to protect the charity by using the Commission's legal powers.



Background – What is driving change?

The refinement of our approach to risk-based regulation in our compliance work is part of a wider process of improvement in the Commission to provide streamlined and effective regulation while minimising the burden on charities. Improvements include, for example, the introduction in 2006 of Charity Commission Direct, the single point of contact for all enquiries and requests coming into the Commission, resulting in faster response times, a better service and quicker decisions about whether we will or will not get involved.

We have taken further steps to ensure our regulation of charities is more proportionate and focussed on risk with serious incident reporting as a key driver. The Annual Return (which can be completed online) now requires trustees to declare that they have reported serious incidents to us. Serious incidents should also be reported to us as soon as possible after they occur, and also to the police and/or the charity's insurers where this is appropriate. This is so we can provide assistance at the earliest opportunity (guidance on reporting serious incidents is available on our website). Such changes represent a part of the Commission's drive to target our resources where the risks are highest.

Our December 2006 stakeholder survey 'Sound strategy for effective delivery' indicated that while more than 50% of respondents think that opening fewer investigations is a positive step, the Commission should not be seen to be soft in this area and must make sure that it acts decisively where needed. There is a suggestion that we do not have a decisive system in place for when we will and will not intervene, and a strong view across stakeholder groups that we need to develop our risk framework to alert us to possible illegal and/or improper behaviour at an earlier stage.

In addition, we have received case-specific criticism in the past from trustees, complainants and beneficiaries, and MPs representing them

that our response is sometimes disproportionately tough, not taking account of the charity's capacity to comply, while in other cases we take an inappropriately 'light-touch' approach.

The Commission's purpose is to achieve its statutory objectives, and so the risk to us as the charity regulator is that we fail to do so. Each part of the organisation plays a role in fulfilling these objectives. For our Compliance function we have identified the following six specific objectives that will enable the Commission to achieve its objectives in the compliance area – promoting trustees' compliance with the law, and increasing public trust and confidence in charity.

The objectives are to:

- deliver effective, timely, proportionate and targeted compliance regulation, ensuring that our intervention is appropriate, and that it properly reflects the seriousness of the problem and the potential impact of our failing to regulate it;
- identify charities that may be facing problems at an early stage, and provide them with support and advice to mitigate or avoid those problems - moving from reactive to proactive casework;
- ensure that we use all the information and intelligence we have about charities to inform how we allocate our regulatory resources;
- continue building more effective partnerships with other regulators, law enforcement agencies and sector bodies in support of risk-based regulation;
- take a strong evidence-based approach, based on continuous evaluation and research into how serious problems arise in charities; and
- ensure that our own staff are well trained and skilled to implement risk-based regulation.

D

Our enhanced approach

Charities must comply with the law. When trustees act reasonably and honestly we respond flexibly and will take this into account in deciding whether to take regulatory action against trustees, and in assessing how to support trustees to put the charity back on a secure footing. Deliberate wrongdoing, illegal activity, criminality and serious abuse will be dealt with rigorously and decisively. An effective compliance and enforcement function in the Commission is, therefore, of vital importance.

Our revised approach recognises that we cannot eliminate, or seek to control, all risks as a regulator. We do not have the capacity to do so. It would also place an unacceptable regulatory burden on charities and would stifle the innovation and adaptability that characterises the sector.

Our enhanced approach to determining risk, and for ensuring that our actions and decisions are appropriate and consistent, moves away from a fairly prescriptive model that awards points for different factors, to a clearer and more flexible traffic light model that categorises risk into Green (low risk), Amber (medium risk) and Red (high risk) issues.

Green issues are routine matters that require less concentrated and/or immediate attention and support. Amber issues are more complex where we apply more resource to provide greater attention and support to resolve difficulties. Red issues are those major and complex issues that present serious risk to the charity and its beneficiaries; these are the issues that will receive the most attention and resources from the Commission.

The traffic light model is a tool used by our compliance staff to assess how a particular issue of concern arising in a charity will be handled and the level of resource the Commission should devote to it; it does not determine, or pre-determine, our ultimate response to the case.

We have identified what we consider to be the most serious issues and areas of greatest risk for charities. These are, in no order of priority:

- significant financial loss to the charity;
- serious harm to beneficiaries and, in particular, vulnerable beneficiaries;
- threats to national security, specifically terrorism;
- criminality and/or illegal activity within or involving a charity;
- sham charities set up for an illegal or improper purpose;
- charities deliberately being used for significant private advantage;
- where a charity's independence is seriously called into question;
- issues that could damage the reputation of an individual charity or class of charities or the wider charity sector;
- issues that could damage public trust and confidence in charities or in the Commission as an effective regulator.

When assessing whether to engage and how quickly, the Commission's enhanced approach is based on levels of tolerance and identifies a number of 'zero-tolerance' issues. When we have concerns that such issues have or may arise in a charity, they receive immediate attention in the Compliance function due to the risks they pose to the charity, its beneficiaries, the public, and the integrity and reputation of charities in general.

Using our risk and proportionality framework we rapidly assess the most appropriate and proportionate course of action to take. This means we determine whether we will engage further with the issue; the level of priority, attention and resources we will give it, and where in the Commission it will be dealt with.

This is based on the particular circumstances, the seriousness and scale of the problem and the available evidence. The 'zero-tolerance' issues are, in no order of priority:

- Charity links to or support for terrorism, financial or otherwise.
- Connections to proscribed organisations.
- Misuse of charity to foster criminal extremism.
- Fraud and money laundering.
- Abuse of vulnerable beneficiaries.
- Not having adequate measures in place to protect vulnerable beneficiaries.
- Sham charities.
- Failure to take significant remedial action by trustees as required by the regulator.

Our assessment of concerns that come to our attention involves evaluating the likelihood of a risk occurring and the potential impact on the charity and more widely. This is informed by our past casework experience. We also take time to validate and verify the reliability and credibility of concerns, including allegations, along with the source of the concern. This includes consideration of previous Commission involvement and the scrutiny of information held by the Commission. It also involves liaison with other regulators, law enforcement and other agencies.

Our response to any case will not be determined just by the issue alone and we will treat each case individually. A risk can be considered more or less serious depending on how it is being managed and controlled by the charity. Some issues may start off as relatively low risk but when combined with a number of other modifying factors could move to being high risk, and we would devote more attention and resources to resolve it. Examples of modifying factors include the following:

- Scale of assets at risk, or already misapplied.
- Annual income and size of assets of charity.
- Public profile of charity (for example, small local charity or well-known household name).
- A high level of public interest. Indicators include interest from the media, parliamentarians and members of the National Assembly for Wales, or from the local community.
- Profile of trustees (number of trustees and the range of skills and experience in the trustee body).
- Risk to charity reputation.
- Risk to public safety.
- Curtailment or withdrawal of services.
- Damage or potential damage to public confidence in the charity, charities generally or in the Commission as regulator.
- Level of co-operation by trustees.
- Charity previously investigated or given advice and guidance on the issue.
- Risk of further harm to charity or beneficiaries.
- Involvement of the Police/other regulator.
- Potential for self regulation through an umbrella body or other charity groups.

Using our risk and proportionality framework will ensure that we prioritise our actions and target our resources where the risks are highest. Our Compliance function's approach to casework is, where possible, to work with trustees to resolve issues through providing supervision, advice and guidance which will allow them to bring the charity back on a secure footing and restore the charity's governance to a proper standard without the need for us to intervene. We follow up after a period of time to satisfy ourselves that the necessary action has been taken by trustees.

In some of the more serious cases of regulatory concern we may open a statutory inquiry under s.8 of the Charities Act 1993. The decision to open an inquiry by senior managers will usually be based on a matrix of factors where there is evidence or serious suspicion of misconduct or mismanagement or risk to property, including where any of the following features are present:

- criminal, unlawful or improper activity;
- necessary to establish and verify facts or collect evidence;
- risk to a charity's reputation or the reputation of charities generally; and
- risk to a charity's beneficiaries.

Added to this, we would also be justified in opening an inquiry under other circumstances including where it is:

- a concern so serious that it warrants us opening an inquiry to investigate the facts and to formalise our engagement with the trustees;
- the only way of getting or verifying the facts;
- where there are risks to drawing conclusions outside the formality of an inquiry, ie of legal challenge;
- where there is significant public interest;
- where there is a need for public accountability in relation to serious issues of concern in administration of charities; and
- where there is a risk to public confidence in the effective regulation of charities.

The seriousness of the issue, whether the risk is ongoing and the level of co-operation of trustees will be additional factors to be considered.

The purpose of an inquiry is ultimately to ascertain the extent of misconduct and mismanagement, if any, assess the risk to the

charity and what action needs to be taken to resolve the concerns. Opening an inquiry facilitates the use of the Commission's regulatory powers of remedy and protection conferred under s.18 (1) and (2) of the Charities Act 1993. We do not open an inquiry solely on the basis that we want to exercise powers that can only be exercised once the inquiry is opened. However, it may be the case that as a result of assessing the risks and what action has to be taken, that we need to use our powers during the course of an inquiry. We will not always use our powers during the conduct of an inquiry, and will only do so where this approach is both proportionate and appropriate in the circumstances.

Our policy is to report the outcome of formal inquiries by publishing a statement of results on our website. We do this to account publicly for our investigatory work. For members of the public, inquiry reports are the most tangible way to understand the key issues of the case, our role as regulator and the impact of any action we have taken. Inquiry reports also set out our conclusions and the wider lessons for other charities.

We now complement these inquiry reports by publishing regulatory case reports at the conclusion of other cases that do not merit a formal statutory inquiry, but where there is significant public interest in the issues involved and the outcome, and where there are lessons that other charities can learn from them. We will only publish reports where we decide that there is sufficient merit to do so.

Further information on both inquiry reports and regulatory case reports is available through the link on the homepage of our website.

When charities, or those connected with them, have committed a criminal offence this is a matter for law enforcement agencies and we will refer suspicions of criminal activities to them as appropriate. This is in line with our general approach to issues of criminality within, or associated with, charities.

Another factor that has an impact on our compliance work and one of the keys to the Commission making good decisions is having access to and making intelligent use of all information available to the regulator. This falls into three broad categories:

- Charity sector analysis – through having a good knowledge and oversight of the sector and by ‘mapping’ what risks there are in the sector through profiling and proactive monitoring, engagement and consultation.
- Organisation specific - drawing on knowledge from sources such as regular and one-off targeted data collection and information/knowledge reviews. This could be information the charity produces itself and displays for example through its website, Annual Returns and accounts and previous case history.
- One-off alerts - this could be media comment, MP letters, whistle blowing, complaints, reports from other regulators, police action and so on.

For further information please contact:

David Walker

Head of Compliance Outreach and Development

Tel: 020 7674 2529

Email: David.Walker@charitycommission.gsi.gov.uk

Charity Commission Direct

PO Box 1227

Liverpool

L69 3UG

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