



CHARITY COMMISSION  
FOR ENGLAND AND WALES

COMPLIANCE TOOLKIT: PROTECTING CHARITIES FROM HARM  
**Chapter 2: Due diligence, monitoring and  
verifying the end use of charitable funds**

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# Contents

1. Introduction	2
2. Trustees' duties and responsibilities	5
3. The risk based approach	8
4. The 'know your' principles	14
5. Know your donor	16
6. Know your beneficiaries	23
7. Working with partners and protecting the charity	28
8. Know your partner	31
9. Monitoring	38
10. Charities operating internationally	52
11. Technical terms used	59
12. Further information	61

# 1. Introduction

The public and those donating to charity should have confidence that money donated is used for legitimate purposes and is reaching its intended beneficiaries. Trustees are legally responsible for ensuring that charitable funds are properly used, adequately protected, and not misused for financial crime, terrorist or other criminal purposes. Trustees are publicly accountable, and have duties and responsibilities under charity law to safeguard their charity, its funds, property and beneficiaries. They may have employees, volunteers and agents to help, but trustees remain legally responsible.

The best way that trustees can ensure a charity's funds are not abused is by putting in place good governance and ensuring there is strong financial management, including robust internal and financial controls and risk management procedures. They should also promote the transparency and accountability of charities and ensure that the public can have trust and confidence in charities and their work.

## Due diligence

Due diligence is the range of practical steps that need to be taken by trustees in order to be assured of the provenance of charitable funds and confident that they know the people and organisations the charity works with, and able to identify and manage associated risks.

'Due diligence' is an important part of trustee duty and is essential in safeguarding charity assets. It means carrying out proper 'checks' on those individuals and organisations that give money to, or receive money from, the charity, including partners and others that are contracted to work with it.

## Monitoring

Where charities give money to partners and beneficiaries, especially large amounts of money or in high risk situations, it's vital to ensure that adequate 'monitoring' takes place. In short, trustees should take appropriate steps to verify that charity funds or property reach their proper destinations and are used how the charity intended. This will allow trustees to have clear oversight of how charity funds are used across the full scope of its operation, whether nationally or internationally.

## 1.1 What is the purpose of this chapter?

**Protecting charities from harm** is guidance designed to help trustees be clear about what their legal duties and responsibilities are and what approach they 'must' (legal requirement) or 'should' (good practice) take for their charity and its work. This approach will depend upon a range of factors, including the nature of charity work and associated risk, the amount of money involved and whether partner organisations operate overseas, particularly in high risk areas.

This chapter explains in detail how trustees can carry out due diligence and monitoring and outlines practical steps they can take to protect their charity's assets, work and reputation. The 'know your' principles section in this chapter will help trustees understand how to comply with legal requirements, particularly when working with partners overseas and in verifying the proper application of charitable funds. The guidance identifies good practice examples and uses case studies to illustrate how the legal duties might apply in practice.

### Who will benefit from this chapter?

This chapter is primarily intended for trustees, but will also be of interest to donors and organisations which give grants to charities to deliver project work in the UK and internationally, so they understand what trustees' responsibilities are under charity law. The 'tools' are particularly aimed at smaller and medium sized charities. The guidance will also assist partner organisations and other delivery agents which charities engage to carry out their work and help them to understand why a charity may have need of certain reporting requirements or information from them.

## 1.2 Due diligence

Due diligence will usually involve judging the quality and completeness of initial information obtained and then deciding whether further checks or enquiries are necessary.

Charities work in a diverse range of situations with a wide range of beneficiaries. Some individuals and organisations donate regularly to charity and have a good, close working relationship. Other donors want to remain anonymous. Both these arrangements are perfectly acceptable and reasonable. It just means charities may need to put in place additional safeguards to protect themselves against those who want to take advantage, while ensuring this does not put off legitimate donors.

### The 'know your' principles

The 'know your' principles section sets out key principles that will help charity trustees to carry out their legal duties and manage the risks to the charity's assets and services. The 'know your' principles are already part of the legal duties and responsibilities of trustees in charity law. They are not new obligations for trustees. Similar 'know your' principles and responsibilities exist in other sectors.

For charities, they can be described in the following three 'know your' principles:

- know your donor
- know your beneficiaries
- know your partner

Applying the 'know your' principles to due diligence and monitoring will help charity trustees to be reasonably assured of the provenance of funds given to their charity, confident that they know the people and organisations they work with, and are able to identify and manage any associated risks.

The 'know your' principles will apply differently to different circumstances. Due diligence needs to take into consideration that, in some cases, charitable activity will be delivered more effectively through partner organisations - perhaps because they know the charity's intended beneficiaries or are located near them. Those partner organisations' credentials, processes and systems can be evaluated. In other cases, assistance and aid may need to be delivered by the charity direct to communities and individual beneficiaries.

The 'know your' principles also complement and are in line with internationally recognised standards, such as those set out in Financial Action Task Force Special Recommendation VIII (FATF SR VIII): "charities should make best efforts to confirm the identity, credentials and good standing of their beneficiaries and associates undertake best efforts to document the identity of their significant donors".

## 1.3 Monitoring

Good monitoring procedures help trustees to fulfil their legal duty to ensure that charitable funds are used for the purposes they should be and reach their intended recipients. They can also help trustees assess and review the key risks to the charity and its funds. The procedures, controls and systems a charity needs to use will depend on the charity and its activities and a number of other factors. There are some things a charity must do as a matter of law. Aside from those, the nature and the extent of the monitoring should be proportionate to the level of risk the charity is exposed to.

## 1.4 Risk based approach

### Why a risk based approach?

The commission will always support charities to deliver legitimate humanitarian aid and other charitable services. The commission appreciates the challenges that some charities may face. This includes, for example, charities working in areas where corruption, violence, or serious or organised crime is common practice, or terrorists and other criminals are known to operate, perhaps where they have some degree of control over access to people in need. For other charities the risks are low. Their activities may be straightforward, they may carry them out themselves, they may collect and use little money and transactions may be less complex. This is why a risk-based and proportionate approach is important and more appropriate than a 'one-size-fits-all' approach.

### Risk based approach in practice

Trustees' legal duties and responsibilities apply to all charities and all trustees, whatever the charity, its size and activities. What this means in practice however depends on the circumstances. The extent, form and detail of the project and partner monitoring checks and due diligence that is required, and how this should extend to donors and beneficiaries, will depend on the nature of the risks in the particular circumstances. The level of checks and procedures required will be dependent on the nature of the activities the charity carries out, and how and where they are undertaken. Where the risks are high - such as in areas where it is well known or likely that proscribed and other terrorist organisations are known to operate - trustees must ensure those steps are sufficiently robust. In this guidance the commission illustrates how these duties may apply in practice for different charities through case studies and examples.

The starting point is: the greater the risks, the more charity trustees need to do to mitigate them.

## 2. Trustees' duties and responsibilities

### 2.1 What are trustees' legal duties and responsibilities for due diligence?

#### The short answer (legal requirement)

Charity trustees must use their charity's funds and assets only in furtherance of the charity's purposes. They must avoid undertaking activities that might place the charity's funds, assets or reputation at undue risk.

In practice, this means that to meet their legal duty to protect charity assets with the necessary care and properly to assess risk, trustees must carry out appropriate due diligence on those individuals and organisations that the charity receives donations from, gives money to or works with closely.

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#### In more detail

Legal requirement: trustees have ultimate responsibility for controlling and managing the affairs of a charity. They must:

- comply with the law (including charity law) and act in the best interests of the charity
- comply with the legal principles of duty of care and duty of prudence and maintain control of charitable funds
- ensure that the charity's funds are used properly, lawfully and in furtherance of the charity's purposes

A trustee's duty of care requires that they exercise reasonable care and skill in carrying out their responsibilities to ensure this is the case.

Trustees must avoid undertaking activities that might place the charity's funds, assets or reputation at undue risk. This duty applies in a number of ways. Charities can take risks. However, as a minimum, trustees must consider, identify and manage the risks and their impact on the charity and its property.

#### Compliance in practice

In order to demonstrate that they have complied with this duty, trustees may need to implement realistic and reasonable risk management strategies to identify and mitigate significant risks to the charity's funds and assets. If these are used they should be relevant and proportionate given the charity's activities and nature of its operations. Risks may take a number of forms, including operational, financial, reputational and external, as well as compliance with the law and regulations. Trustees' duty of care requires that they exercise reasonable care and skill in the circumstances, in carrying out their responsibilities to ensure this is the case.

As well as protecting the charity from internal abuse, it is also the responsibility of charity trustees to exercise reasonable care over the selection, use and monitoring of a charity's partners, donors and beneficiaries. When choosing partners to work with, trustees must conduct proper due diligence checks relevant to their charity and the risks to ensure that they are appropriate partners for them to work with. They must also take reasonable steps to ensure the charity's funds will be properly used.

For more information about trustees' duties, see **The essential trustee: what you need to know, what you need to do (CC3)**.

## 2.2 What are trustees' legal duties and responsibilities for monitoring the end use of funds?

### The short answer (legal requirement)

Charity trustees must use their charity's funds and assets only in furtherance of the charity's purposes. They must ensure that funds are properly protected so that, for example, they are not used for illegal or improper purposes, including for terrorist and other criminal purposes.

In practice, a significant aspect of a trustee's legal duty to protect charitable assets with the necessary care means ensuring that where a charity gives money to partners or beneficiaries, or uses partner and delivery agents, or where it funds other projects, charity trustees must properly and appropriately monitor the use of the charity's funds, checking both that funds reach their destination and that they are used for the purposes intended.

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### In more detail

#### Monitoring end use of funds - trustees' responsibilities

Legal requirement: in order to comply with their duty of prudence, trustees must use charitable funds only in furtherance of the charity's purposes, as set out in its objects. They must also ensure that the charity's funds are spent for the purpose for which they were raised. Trustees' duty of care requires that they exercise reasonable care and skill in the circumstances in carrying out their responsibilities to ensure that this is the case.

#### Unlawful use of charitable funds

The use of charity money or property for unlawful purposes cannot in any circumstances be regarded as a proper use, and is in breach of charity law. It is not acceptable for a charity to carry out activities that are unlawful either in the United Kingdom or in an overseas country in which it operates. Trustees might not be able to protect their charity entirely from criminal abuse, but they have a legal duty of care to the charity and must therefore take reasonable steps to protect it as best they can. This duty of care applies to the protection of all of the charity's property, including funds, property and reputation.

#### Responsibility outside of the trustee board

Others may also have a role in supporting trustees in carrying out these responsibilities, such as staff they employ to carry out a monitoring role or internal and external auditors or independent examiners. Grant-funding bodies that carry out monitoring may also assist. However, trustees need to remember that they remain responsible and accountable for ensuring proper monitoring takes place and their legal duties are met.

#### Legal liability

Under charity law, trustees are accountable for the proper and legitimate use of funds in furtherance of their charity's purposes. In extreme cases, if funds have not been properly used, and the trustees failed to take reasonable steps in the circumstances to protect them and ensure they could be accounted for, trustees may have to repay any loss to the charity. Moreover if a charity incurs non-charitable expenditure its tax reliefs can be restricted and the charity may be required to pay tax on its income and/or capital gains (see the **HMRC website** for further information).

Trustees must therefore act prudently in the receipt and expenditure of charitable funds. They must ensure that the funds received by the charity are legitimate. When using funds to support charitable activity, trustees must ensure they take reasonable steps, taking account of the particular circumstances, to protect the funds from being abused, including for criminal and terrorist purposes.

This means that the trustees must exercise sufficient control over their charity's financial affairs and act prudently in choosing their partners. As an absolute minimum, they must keep proper and adequate financial records for both the receipt and use of funds and audit trails of decisions. Records of both domestic and international transactions must be sufficiently detailed to show that funds have been spent properly as intended and in a manner consistent with the purpose and objectives of the organisation. Grants made to other organisations must be disclosed in accounts.

These legal responsibilities underpin and operate alongside good internal governance, transparent accountability and strong financial management. Ensuring proper internal and financial controls and risk management procedures are in place and implemented is vital.

## 3. The risk based approach

### 3.1 What is a risk based approach?

#### The short answer

As a guiding principle, the greater the risks, the more charity trustees have to do to ensure and to demonstrate that they have discharged their duty of care and other legal duties.

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#### In more detail

A risk based and proportionate approach in this context means that actions trustees take to comply with these duties:

- stop abuse of the charity, its funds and property taking place
- use greater effort and stronger measures for higher risks, meaning for some risks, trustees must take certain action but for other risks, there is greater discretion and flexibility about what to do
- take account of the amount of money at risk as a significant factor, although this will not and cannot be the only factor - in some cases, where there are very high risks a number of important steps are still required to safeguard what might be a relatively small amount of money from the charity's perspective

and, to the extent that is reasonably possible:

- are flexible enough to adapt to and complement the charity and its work
- avoid negative impact on people donating to or benefiting legitimately from the work of the charity
- do not duplicate the work or responsibilities of others
- are not unduly costly or administratively burdensome for the charity, although a short term or one off cost needs to be assessed against the long term benefits, assurances required and donor and public expectations; but trustees should do what is necessary at their discretion even if there are associated costs

### 3.2 Can trustees apply a risk based approach to these duties?

#### The short answer

Legal requirement: trustees cannot apply a risk based approach as to which duties apply or they choose to comply with. The legal duties explained previously apply to 'all' trustees of 'all' charities subject to the law of England and Wales, whatever their income, whether registered with the commission or not and whether or not they are based, operate or work internationally.

However, what action is reasonable or proportionate to take to ensure trustees comply with these duties will vary from charity to charity. Charities can apply a risk based approach to this.

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#### In more detail

What an individual charity and its trustees must or should do in their charity and what is a reasonable and proportionate approach to adopt when taking action to comply with those legal duties will depend on a range of factors.

It will, for example, depend on:

- different aspects of a charity's work and the risks which arise
- how much money is involved
- whether partners and funds are overseas and what local problems there are - for example in areas of conflict

Legal requirement: all charities must have, as a minimum:

- some form of appropriate internal and financial controls in place to ensure that all their funds are fully accounted for and are spent in a manner that is consistent with the purpose of the charity – what those controls and measures are and what is appropriate will depend on the risks and the charity
- proper and adequate financial records for both the receipt and use of all funds together with audit trails of decisions made – records of both domestic and international transactions must be sufficiently detailed to verify that funds have been spent properly as intended and in a manner consistent with the purpose and objectives of the organisation
- given careful consideration to what due diligence, monitoring and verification of use of funds they need to carry out to meet their legal duties
- taken reasonable and appropriate steps to know who their beneficiaries are, at least in broad terms, carried out appropriate checks where the risks are high and have clear beneficiary selection criteria which are consistently applied

As regards monitoring, in most cases, some form of monitoring is likely to be required.

In all these cases, the more complex or significant the activity or project for the charity, the more money or the higher the number of transactions involved, the more steps that are likely to be required as reasonable to ensure a trustee complies with these duties, even when balancing this with the volume and cost of administration this may involve. What is appropriate and proportionate therefore depends on the nature of the risk, its potential impact and likelihood of occurring. What is important is for trustees to be able to show that the action they have taken is reasonable in light of those risks and actions.

The existing requirements for independent examination and audit in larger charities may assist trustees, but they should not be relied on as the only way or fail safe way of ensuring no abuse takes place.

### 3.3 Why is identifying and assessing the specific risks important?

#### The short answer

Risk to the charity and its work directly affects what sort of due diligence, monitoring and action the trustees need to take to ensure charitable funds are used properly by the people they give them to.

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#### In more detail

It is vital that trustees identify and assess the risks to the charity because the impact of these risks on the charity's work directly affects:

- what sort of due diligence the charity trustees need to carry out
- what organisations and individuals they need to carry this out on
- what monitoring procedures they need to have and apply
- what action they need to take to ensure charitable funds are used properly by the people they give them to

Charities that are required by law to have their accounts audited must also make a risk management statement in their trustees' annual report confirming that '... the charity trustees have given consideration to the major risks to which the charity is exposed and satisfied themselves that systems or procedures are established in order to manage those risks' (Charities (Accounts and Reports) Regulations 2008).

All other charities are encouraged to make a risk management statement in their accounts as a matter of good practice. Some charities that are companies must also under company law include a business review in their directors' report which contains a description of the principal risks and uncertainties facing the organisation.

### 3.4 How do trustees identify and assess the risks?

#### The short answer

Trustees need to be aware that the risks that a charity faces depend very much on the size, nature and complexity of the activities it undertakes, and also on its finances.

As a general rule, the larger and more complex or diverse a charity's activities are, the more challenging it will be for the charity to identify the major risks that it faces and put proper systems in place to manage them. This means that formal risk management processes may be necessary to help trustees and that these will need to be tailored to fit the circumstances of the individual charity, focusing on identifying the major risks. In most cases, trustees of large, complex charities will need to explore risk more fully than smaller charities and in greater detail than given in this guidance.

How trustees identify and assess risk and what tools they use to help them to do so is up to them. The commission provides a description of some of the 'tools available' which may help trustees, particularly trustees of smaller and medium sized charities.

Further practical advice and guidance on assessing and managing risk generally can be found in the commission's guidance **Managing charity assets and resources (CC25)**.

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#### In more detail

Most charities are likely to identify and consider risk in the context of their day-to-day activities and incorporate this in their management processes and decision making.

Identifying and managing the possible and probable risks that a charity may face is a key part of effective governance for charities of all sizes. Managing risk effectively is essential if charity trustees are to achieve their key objectives and safeguard their charity's funds and other assets. Charity trustees need to identify risks that the charity faces and decide whether the systems and procedures they have in place to address them are adequate, reasonable and proportionate.

Risks may take a number of forms, including for example:

- operational
- financial
- reputational
- external
- compliance with the law and regulations in the UK and, if applicable, internationally

In order to comply with their basic duties, charity trustees should consider the full range of risks. How trustees identify and assess risk and what tools they use to help them to do so is up to them. Smaller charities with simple activities and facing low risks, may need to do nothing more than ensure they are aware of the risks and take them into account in decision making. However, in more complex situations, having a structured process or methodology may be helpful for ensuring key areas of risk arising from both internal and external factors are considered and identified and the trustees can demonstrate that this has been done.

Some charities find carrying out a formal written risk assessment, either relating to their work as a whole or to specific projects or work streams, helps trustees make informed decisions in relation to the charity's operation. It also highlights any gaps where further scrutiny may be needed, and procedures developed. There are a number of models and frameworks which may be helpful. Some of these are referred to or provided as 'tools' for trustees.

### **Risk management strategy**

If trustees do not have a formal risk management strategy, they will need to be able to show how they are meeting their legal duty to protect the funds and property of the charity and applying them properly by considering and managing risks in a realistic and reasonable way. If they do have a risk management strategy, this needs to be reasonable in light of the size of the charity and relevant to its activities and the nature and extent of its operation.

### **Responsibility of management, staff and volunteers**

The responsibility for the management and control of a charity rests with the trustee body and therefore their involvement in the key aspects of the risk management process is essential, particularly in setting the parameters of the process and reviewing and considering the results. This should not be interpreted as meaning that the trustees must undertake each aspect of the process themselves. In all but the smallest charities, the trustees are likely to delegate elements of the risk management process to staff or professional advisers, but they do not delegate their responsibilities for it. The trustees should review and consider the key aspects of the process and results. If they do not ensure that they are properly informed of relevant risks before important operational decisions are made, it would be difficult to see how they can properly discharge their duties as charity trustees.

### **The risk management process**

Reporting in the trustees' annual report on the steps a charity has taken to manage risk helps to demonstrate the charity's accountability to its stakeholders including beneficiaries, donors, funders, employees and the general public.

Risk management is a dynamic process ensuring that new risks are addressed as they arise. It should also be cyclical to establish how previously identified risks may have changed. Risk management is not a one-off event and should be seen as a process that will require monitoring and assessment. It needs to be clear who has responsibility for implementation. If a charity has staff there should be communication with them (and, where appropriate, volunteers) at all levels to ensure that individual and group responsibilities are understood and embedded into the culture of the charity. A successful process will usually involve ensuring that:

- new risks are properly reported and evaluated
- risk aspects of significant new projects are considered as part of project appraisals
- any significant failures of control systems are properly reported and actioned
- there is an adequate level of understanding of individual responsibilities for both implementation and monitoring of the control systems
- any further actions required are identified

- trustees consider and review the annual process
- trustees are provided with relevant and timely interim reports

Some practical 'tools' can be found as annexes to this guidance, particularly to assist trustees in assessing risks as they affect a charity's due diligence, and monitoring of the end use of charitable funds.

### 3.5 For due diligence and monitoring, what factors are likely to affect the level of risk?

#### The short answer

In the context of trustees' due diligence and monitoring responsibilities, the risks are affected by a number of factors. These centre on what activities the charity undertakes, where, how and by whom.

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#### In more detail

In the context of due diligence and monitoring responsibilities, the risks are affected by a number of factors. For example:

- 'what' activities are being carried out?
- 'how' are activities going to be delivered and the timescales involved?
- 'who' will carry them out? Will it be staff controlled and supervised by the charity?

If a charity is using other organisations as partners or agents, this may or may not increase the risks. By using third parties, trustees may manage the risks to their staff and to the charity, but only as long as the trustees put in place good monitoring and reporting arrangements and formalise the relationship to protect the charity. If proper safeguards are not put in place this may increase the risks to the charity

- 'where' will the project be based?

The risks may increase where it is in a conflict zone or within a local community under the influence of individuals linked to terrorism, or where criminals are known to operate. The risk will vary if it is in a region or country which is currently unstable or where the infrastructure is poor (see section 11).

There may be additional factors to consider in respect of risks because of local issues. Are there local disputes which will affect delivery of the project? For example, will the local dispute mean certain people may be excluded from participating in the charitable activity or that certain people will be given preference or only allowed to participate, whether or not they have charitable needs? Or, for example, do the partners or beneficiaries who may operate in a different regulatory system understand what they need to do for the charity?

- what 'methods' are used to safeguard charity funds?

In order to operate effectively and transparently when delivering aid or undertaking other charitable work, every charity should have access to formal banking facilities. It is a decision for the charity as to which bank or organisation they choose to hold their account. However, the commission would have serious concerns if a charity were not able to operate because of a lack of banking services. If financial services are declined or withdrawn from a charity, harm could result to its charitable work, its ability to operate transparently and ensure it can safeguard its funds. If the charity or a local partner has to use cash, or alternative money systems and payment mechanisms, such as Money Service Businesses (MSBs) or cash couriers, then they will need to take extra precautions and do more to protect the funds and ensure close monitoring of their use. Charities should not use unregistered MSBs and should check the **HMRC's online register**. (See also **chapter 4** for further guidance on storing and moving funds.)

- the 'public profile' of the proposed work and the likely media and/or local or public interest in it
- where 'third parties' may be involved, and not just delivery partners, what degree of influence or control does the charity exert, for example, is the charity able to carry out adequate monitoring?

Trustees also need to bear in mind that some risks may only become evident once a relationship with a donor, beneficiary or partner or the work has begun. As these materialise, the risks are likely to need to be reassessed.

## 4. The 'know your' principles

### 4.1 Why is due diligence important?

#### The short answer

In order to ensure that they are fulfilling their duty to manage their charity's funds properly, trustees need to know where the funds come from, how they are to be applied in accordance with the charity's objects and who will be involved in delivering the charitable services.

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#### In detail

The voluntary nature of charities and their areas of work can make them vulnerable to people who want to misuse charities for their own gain. Charities are highly valued in society and the very nature of charities can make them attractive targets for criminal abuse such as fraud, theft and money laundering. People also abuse charity for private advantage, for example by ensuring a charity uses a particular organisation or individual to provide services which are not necessarily charged on the best terms available. Financial abuse and crime can result not only in a significant loss of charitable funds but also in damage to public trust and confidence in charities more generally.

#### Examples

A charity might engage a person or organisation to provide charitable services on its behalf to beneficiaries. Without proper due diligence the charity might be persuaded to drop standards and use a provider who in reality they know little about or whose services are below par and not value for money. This can create opportunities for others to abuse the charity and allow some of the charity's funds to be diverted for criminal and other purposes.

Incidents of abuse of charities are small in number compared to the size of the sector. However, it does happen, and when it does the impact on the charity and its work can be great. It also affects public trust and confidence in charities. The number of incidents of abuse the commission is aware of is increasing, so it is important that charities take this risk seriously.

Some charities may be at greater risk because of the activities they undertake or their structure, for example, numerous fundraising branches spread over wide geographical areas, where controls are hard to implement. However, no charity is immune so all charity trustees must ensure that they are aware of and assess the risks and take proper steps to manage them.

Criminals may exploit charities by misappropriating charitable funds through fraud, theft, money laundering or diverting charitable funds from legitimate charitable work. Examples of the types of fraud and financial crime that charities may be susceptible to include:

Donations: using a charity to launder proceeds of crime, or to make a credit card donation to test whether a stolen card still operates.

Partners: submitting false or inflated invoices or purchase orders for funds to be paid by the charity.

Beneficiaries: making fake grant applications or creating false or inflated numbers of beneficiaries, for claims and other forms of identity fraud.

Charities working internationally may be exposed to particular risks inherent in the environment in which they operate. Further information on the particular issues affecting charities operating overseas can be found in the commission's guidance **Charities: how to manage risks when working internationally**.

It can be difficult to identify financial abuse as criminals may be adept at presenting their interests and activities as legitimate and lawful. Establishing the identity and legitimacy of any organisation the charity works with can help reduce some of these risks. For example, without appropriate due diligence in high risk situations, trustees are not going to be able to identify whether a partner or beneficiary is designated or a proscribed organisation in the UK (see chapter 1, **modules 5** and **6**).

Working to these principles helps trustees ensure they comply with their legal duties and responsibilities to safeguard the charity's funds and property. Following the principles will also enhance their charity's transparency and accountability, which in turn will help build the trust and confidence of a charity's donors, supporters, partners and beneficiaries.

## 4.2 What are the 'know your' principles?

### The short answer

These are the principles that trustees should follow to ensure that they meet their legal duties under charity law when they are selecting donors, partners and beneficiaries.

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### In more detail

The essence of the 'know your' principles is already key to the legal duties and responsibilities of trustees in charity law. These requirements are not new.

Similar duties and principles exist in other sectors. In the financial sector, for example, banks and other institutions have to take reasonable steps to ensure that they know who they are doing business with.

For charities, the requirements can be summed up in the following 3 'know your' principles:

- know your donor
- know your beneficiaries
- know your partner

They are designed to help charity trustees know how they can be assured of the provenance of their funds and that they know the people and organisations they work with.

They are the principles that trustees should follow to help ensure they meet their legal duties under charity law. Trustees must exercise reasonable care over their selection and use of donors, partners, and beneficiaries. The principles are about the reasonable steps a trustee should take to know who the charity's donors are, who its beneficiaries are and who the partners are the charity plans to work with. They help ensure those individuals and organisations are appropriate for the charity to be involved with. For example, that the beneficiaries are within the class of beneficiaries a charity is allowed to help, that it is safe to accept money from a donor and that trustees can help ensure a partner they are choosing will deliver what the charity wants them to and they are appropriate partners for a charity to work with.

To satisfy the core elements of due diligence trustees must take reasonable steps to ensure they:

- 'identify' - know who you are dealing with
- 'verify' - where reasonable and the risks are high, verify identities
- 'know what the organisation's or individual's business is' and can be assured this is appropriate for the charity to be involved with
- 'know what their specific business is with your charity' and have confidence they will deliver what you want them to
- 'watch out' for unusual or suspicious activities, conduct or requests

## 5. Know your donor

### 5.1 What do trustees need to do for 'know your donor'?

#### The short answer

Most charities should know, at least in broad terms, where the money they are being given comes from (eg grants, cash donations etc). Trustees should also be able to identify and be assured of substantial donations. A good, open and transparent relationship between a charity and its donors is essential for building trust and confidence. It will help to ensure that expectations and commitments are clear, and may encourage longer term funding.

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#### In more detail

Trustees should take reasonable and appropriate steps to know who the charity's donors are, particularly where significant sums are being donated or the circumstances of the donation give rise to notable risk. Good due diligence will help to:

- assess any risks to the charity that may arise from accepting a donation or certain types of donations
- ensure that it is appropriate for the charity to accept money from the particular donor, whether that is an individual or organisation
- give trustees reasonable assurance that the donation is not from any illegal or inappropriate source
- ensure that any conditions that may be attached are appropriate and can be accepted

Charity trustees need to put effective processes in place to provide adequate assurances about the identity of donors, particularly substantial donors, taking steps to verify this where reasonable and it is necessary to do so (ie 'identify' and 'verify'). They should also have assurance on the provenance of funds and the conditions attached to them 'ie know what the donor's specific business is with your charity' and ensure they know the rules of, and their responsibilities under, relevant legislation on substantial donors.

This does not mean charities have to question every donation. Nor must they know lots of personal and other details about every donor.

#### Small and regular donations

Some donors give relatively small amounts of money as a one off donation, by cheque, bank transfer or cash. Some charities may raise significant funds from fundraising events in public cash collections, such as fun runs, in public appeals for money in humanitarian disaster appeals (for example following tsunami or earthquake disasters), and through charity boxes. Charities are not expected to know the identity or take steps to find out the identity of each small cash donor in these sorts of circumstances. This would not be reasonable or necessary.

Some individuals and organisations will donate regularly to the charity and set up regular payments through direct debits. Trustees will already have the name, address and details of those donors and their bank details to collect the money and if they wish to collect gift aid. Therefore it is unlikely that a charity will need to take any further steps here.

If the charity is claiming Gift Aid it is required to maintain a record of the donor's details (the name and postcode are the minimum requirements).

## Recording donor information

Legal requirement: when obtaining and recording personal records, charities must comply with the Data Protection Act 1998 which provides a framework to ensure that personal information is handled properly and in accordance with the rules on data protection.

Some charities use commercial participators and professional fundraisers to collect money for them. The use of such organisations does not relieve charity trustees of their responsibilities, so they should ensure that they monitor the activities of such third parties.

Further information about fundraising generally, safer giving and requirements for running fundraising events can be found in the commission's guidance **Charities and fundraising (CC20)**.

## Legacies and wills

For charities that receive legacies from wills, ensuring good receipt from the executor of the will is important. Larger charities will have established systems and legacy officers. For trustees of smaller charities, many legacies will be paid by a firm of solicitors or practitioners who specialise in this area. Trustees can take steps to ensure they are registered with their regulatory bodies and can ask to see a copy of the will if they have specific concerns or worries. Trustees can also obtain a copy of the will from the Probate Service if they have details of the grant of representation. Further advice and guidance can be found on the HM Courts Service website.

## Large grants and donor relationships

Other donors give significant grants to charity and the charity may have a close working relationship with them. It is for significant donors like these that trustees are likely to need to carry out further due diligence and take steps to identify and verify the identity of the donor so they can assess any risks. For example, if you know that the donor you are familiar with is from a country or operates a business, perhaps outside of the UK, about which public concerns have been raised, then the trustees should take more steps to verify the provenance of the funds.

If there is a significant donor which is an organisation, the charity 'should know what its business is' and be assured that the organisation is appropriate for the charity to be involved or linked with. If a donor is a charity, its registration and details can be checked with the relevant charity regulator, for example in the case of England and Wales on the Register of Charities. If the donor is a company, its details can be checked on the Companies House website.

Sometimes risks can be identified by carrying out a check on the organisation's website or using other internet search engines to look at other information written about it. However, care should be taken to assess how reliable the information is. For example, is the information repeating allegations others have made? Were they proven? How old is the information?

## Benefits of demonstrating due diligence

In accordance with their duties to act in the best interests of the charity and maintain its integrity, trustees should consider carefully donations from sources that might be seen to compromise the charity's reputation, independence and work. Key benefits of due diligence steps are:

- ensuring trustees have a reasonable degree of confidence about the provenance of the donation and that there is no reason to believe it is suspicious
- exposing legal reasons why the charity should not accept the donation (for example because the organisation is proscribed or there is a significant risk that the money comes from illegal sources) or operational reasons (for example the donor's activities or ethics may give rise to risks to the charity)

- identifying if there are any requirements or conditions attached to the donation – sometimes the conditions may mean a charity has to refuse the donation; if the gift is made by will then the charity should contact the commission to find out whether or not the commission's authority is needed to refuse this
- understanding the intentions of donors and any restrictions placed on the money received - a good relationship with donors which is open and transparent is essential for building trust and confidence and ensuring that the expectations and commitments of both parties are clear, being clear about this will also ensure that the charity does not disappoint its donors where there are expectations, and could help with securing longer term funding

## 5.2 Can a charity accept anonymous donations?

### The short answer

Yes, providing trustees look out for suspicious circumstances and put adequate safeguards in place.

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### In more detail

The 'know your' donor principle does not mean charities cannot accept anonymous donations. Some donors want to remain anonymous. This is perfectly acceptable providing charities look out for suspicious circumstances and put adequate safeguards in place. Charities operating abroad will need to check whether the acceptance of anonymous donations complies with local law or local tax regulations.

## 5.3 Can a charity accept donations that have conditions attached?

### The short answer

Yes, charities are free to accept donations with conditions attached, provided that those conditions are not illegal and they are compatible with the purposes, priorities and activities of the charity.

If the conditions are so stringent that they could undermine the charity's independence, the trustees may need to refuse the donation.

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### In more detail

Where donors seek to attach conditions to the donations they give to a charity, the charity trustees should consider whether the condition is compatible with the purposes of the charity as well as their current priorities and planned activities. If the conditions are so rigid that they could undermine the charity's independence, the trustees may need to refuse the donation.

Legal requirement: the law requires charity trustees, in deciding whether to accept or refuse a particular donation, to consider the charity's best interests, taking an overall view. The law allows practical and ethical factors to be taken into account as long as these are likely to affect the specific interests of the charity.

Where there is a cause for concern about a particular conditional donation the trustees can consider refusing it. In such circumstances the charity might wish to seek advice or authority from the commission in order to provide the trustees with comfort that their decision has been properly taken.

Decisions made to refuse donations and accept high risk donations should be recorded as this will demonstrate that the charity has identified and properly considered the risks and is transparent about the decision-making process. This is important for being able to show that the charity trustees have acted responsibly.

It is good practice to ensure relevant staff are sufficiently trained on the issues about accepting donations and if the charity has a particular policy or procedure in place that they are familiar with it. Charity trustees should ensure that appropriate procedures are in place for recording and processing donations and grants and that these are monitored and reviewed.

Further information can be found in the Institute of Fundraising's **Acceptance and Refusal of Donations Guidance**.

## 5.4 How can trustees identify suspicious donations?

### The short answer

Most charities will be familiar with the source and nature of donations that they receive. The key to identifying suspicious donations is to look out for exceptional features, such as unusually large amounts, conditions or complex banking and transfer arrangements.

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### In more detail

Charities should, as a matter of good practice, have policies and procedures in place both to ensure that staff and volunteers are aware of the risks, and to ensure that trustees and staff are alerted to any suspicious donations and know what to do. Charities should take reasonable steps to ensure staff and volunteers know how to identify suspicious donations and what to do if they find one.

Unsolicited donations might be suspicious, especially if the charity trustees are unable to satisfy themselves about the credentials of the people involved, or the propriety of the donation or loan. Donations may take forms other than money, for example shares or goods. Trustees should of course remember that the donor might be entirely legitimate, but they should not rule out the possibility that somebody is trying to exploit the charity.

The following situations may indicate higher risks:

- unusual or substantial one-off donations or a series of smaller donations or interest-free loans from sources that cannot be identified or checked by the charity
- if conditions attached to a donation mean that the charity would merely be a vehicle for transferring funds from one individual or organisation to another without the trustees being able to satisfy themselves about the appropriateness of their use and that they have been used as intended
- where a donation is made, the charity is told it can keep it for a certain period of time, perhaps with the attraction of being able to keep any interest earned whilst holding the money, but the principal sum is to be returned at the end of a specified, short, period
- where donations are made in a foreign currency, and again unusual conditions are attached about their use, including a requirement that the original sum is to be returned to the donor in a different currency
- where donations are conditional on particular individuals or organisations being used to do work for the charity where the trustees have concerns about those individuals or organisations
- where a charity is asked to act as a conduit for the passing of a donation to a second body which may or may not be another charity
- where a charity is asked to provide services or benefits on favourable terms to the donor or a person nominated by the donor

## Other factors which may alert suspicion

Whilst some of the examples above may be donations made in good faith, other factors combined with these examples may alert the trustees that the donation or circumstances could be suspicious. For instance, trustees should consider the timing of the donation, the country of origin, the amount donated and the frequency of the donations. Similarly, they should question payments received from a known donor but through an unknown party or an unusual payment mechanism where this would not be a typical method of payment.

Closer attention may need to be paid with donations which are received from unknown bodies or international sources where financial regulation or the legal framework is not as rigorous as in the UK. These examples may be useful indicators to the trustees that they may need to make further enquiries before accepting the donation. They may need to refuse a donation if they do not receive satisfactory replies to their enquiries.

## 5.5 What do trustees need to do if they identify a suspicious donation?

### The short answer

If due diligence checks reveal evidence of crime, trustees must report the matter to the police and/or other appropriate authorities. Charities should have clear policies and procedures in place so that trustees, staff and volunteers know how to recognise suspicious circumstances and who to report them to. Where trustees judge these incidents to be serious, they should be reported to the Charity Commission via **RSI@charitycommission.gsi.gov.uk**. For more information about reporting serious incidents, see the guidance **How to report a serious incident in your charity**.

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### In more detail

As some criminals look to legitimate organisations to facilitate money laundering or financial crime, trustees need to be aware of these risks. The commission is aware of cases where donations or loans to charities have been used to facilitate money laundering or other criminal activity.

There is a marked overlap between money laundering and terrorist financing – both criminals and terrorists use similar methods to store and move funds. However, the motive for generating and moving funds differs. Terrorists ultimately need money to commit terrorist attacks. Unlike criminal gangs, terrorist groups involve disparate individuals coming together through a shared motivation and ideology.

Charities should have clear policies and procedures in place both to ensure that its trustees, staff and volunteers are aware of this risk, and to ensure that trustees and/or senior staff are alerted to any suspicious donations.

A charity's responsibility is not to work out if a donation is illegal or if it may be asked to use it for illegal purposes. However, trustees should carry out good due diligence and report concerns and suspicious activities to the appropriate authorities, including the commission.

Where there is a cause for concern about a particular donation because, for example, it is unusually substantial or forms part of an unusual series of smaller donations, or is an interest-free loan:

- check the donor against the consolidated lists of financial sanctions targets and proscribed organisations (**see chapter 1 Charities and terrorism**)
- consider whether to refuse the donation– in such circumstances the charity might wish to seek advice or authority from the commission in order to provide the trustees with comfort that their decision has been properly taken

- if the trustees suspect that the purpose of the donation may be to facilitate criminal activity, they must report this to the police and the commission immediately – ensure you obtain a crime reference number from the police
- if the trustees have reasonable cause to suspect that a donation is related to terrorist financing or money laundering, they are under specific legal duties under criminal law to report – terrorism offences must be reported to the police, with regard to money laundering, disclosure can be made to the police, an HMRC customs officer, or an officer from the National Crime Agency (NCA)

### Reporting to the Charity Commission

Under the serious incident reporting regime trustees should make a report to the commission if significant sums of money or other property are donated to the charity from an unknown or unverified source. This could mean an unusually large one-off donation or a series of smaller donations from an unfamiliar, unverified or anonymous source; donations may take forms other than money, for example shares or goods. As a guide, trustees should report, via email, unverified or suspicious donations totalling £25,000 or more.

Trustees also need to be alert to the risk that individuals may be raising funds in the charity's name that never reach the charity, or where only some of the money is passed on. If trustees have concerns that this might be the case, again, they need to report this to the appropriate authorities.

The commission has included examples of the type of questions that charity trustees may need to consider in a **quick list**.

## 5.6 What do charities need to know about the tax treatment of substantial donations?

Legal requirement: the Finance Act 2006 introduced legislation covering 'substantial donations' with which charities must comply.

Charities should ensure that they know the rules of, and their responsibilities towards the tax legislation on substantial donors. The Finance Act 2006 introduced legislation to counter the abuse whereby a donor gets relief from tax on their donations, only for the capital from the donation to end up back in the hands of the donor. The rules cover a broad range of transactions including the sale or letting of property and the provision of services and financial assistance, including investment by the charity in the substantial donor's business.

Charities affected by this will be those which receive tax relievable donations of £25,000 or more in a 12 month period, or £150,000 or more in a period of 6 years from a particular donor.

However at the time of writing these rules are likely to be re-written. The **HMRC website** should be checked for the latest information.

## 5.7 Case studies relating to 'know your donor'

The following 2 case studies illustrate situations in which the risks to the charities were high and the trustees should have undertaken more due diligence to ensure they fulfilled their duty of care.

1. An unregistered appeal was established mainly to provide medical assistance to the people of Iraq.

The commission opened a statutory inquiry to ascertain whether funds resulting from contracts made under the United Nations Oil-for-Food programme were donated to the charity and, if so, to establish the legal status of those funds and to examine the extent to which the trustees of the charity properly discharged their duties and responsibilities in receiving those funds.

The commission found that the charity had received significant donations connected with improper transactions made under the UN Oil-for-Food programme and in accepting these funds the commission found the trustees were not sufficiently vigilant and did not properly discharge their legal duties regarding these donations.

The charity trustees knew about the sanctions placed on Iraq and the UN Oil-for-Food programme. Given the complex setting within which the charity had to work, the commission's view was that the trustees should have been extremely vigilant in their acceptance of these donations. The trustees did not make sufficient enquiries as to the source of the donations, or assess whether it was proper and in the interests of the charity to accept them.

2. In the course of a statutory inquiry the commission established that over \$150m was paid into a bank account which had been set up in a charity's name. The bank was suspicious of the origin of the money and so returned it to the remitting bank in the USA. When the funds were returned, the interest (£24,000) was not paid to the charity but to the owner of the group of companies from which the funds had originally been paid.

In light of the highly unusual nature of the arrangement with the owner, and the context of a small charity with no established income stream or track record, the charity trustees failed to take adequate steps to ensure that they were acting prudently when entering into the arrangement. In particular, they should have established the provenance of the funds. They also permitted the owner to have sole signatory rights of the dollar account and so failed in their fundamental duty to maintain control of charity property at all times. They were unable to produce any records of the arrangements or transactions and failed, therefore, to comply with their duty to keep proper books. The trustees also failed to fulfil their legal duty to provide the commission with substantive information to demonstrate that the arrangements were in the best interests of the charity.

No monitoring processes or subsequent assessment of these arrangements were undertaken by the charity trustees in order to determine whether the activities were or had been appropriate and in the best interests of the charity.

The fundraising methods adopted by the charity were high risk and have not benefited the charity. Had the charity derived any income from the fundraising schemes it may have been the subject of criticism and/or legal action, so damaging the reputation of the charity and the sector. The charity was removed from the register.

## 6. Know your beneficiaries

### 6.1 Does the 'know your beneficiaries' principle apply to all charities?

#### The short answer

There are no minimum legal requirements as to what charity trustees should do to comply with the 'know your beneficiaries' principle. It will not apply to all charities and a common sense approach is required.

The 'know your beneficiaries' principle is more likely to apply to charities which restrict access to services or activities to a certain number of beneficiaries.

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#### In more detail

Charities carry out a vast range of activity and delivery of services in pursuit of their charitable purposes whether in the UK or overseas and in diverse circumstances, and a common sense approach needs to be engaged in applying the 'know your beneficiaries' principle.

#### Charities and their beneficiaries

Charities use a variety of ways to reach those they aim to assist through charitable activities and providing funding. They may work directly with beneficiaries and individuals, groups and communities using their own staff and resources. They may work in collaboration and partnership with other organisations, including other governments. Because of their contact with, knowledge of and reach into local communities, charities are often uniquely placed to work with them to accurately identify those to whom the aid, assistance or services should be most appropriately targeted and how.

The identification and selection of beneficiaries are important decisions for charities. Sometimes this is specified in the charity's governing document and this will make it a legal requirement. Other trustees will have more discretion about selection criteria. They may have decided on a policy to guide their decision making.

Ensuring trustees make decisions which are legally valid and exercise their discretion properly, taking account of any due diligence, are an important part of good trustee decision making and help ensure they discharge their duty of care.

Some charities' activities are available to and open to everyone, and are fully accessible to members of the public. For example, a charity may provide a recreation ground. The charity does not choose its beneficiaries as such and clearly, there is no need to check and verify the identity of members of the public who walk across or use the ground.

Some charities will not have individually identifiable beneficiaries, for example, a charity carrying out environmental work for the benefit of the public in a particular town or village. So again, the 'know your beneficiaries' principle will not have specific application.

In the context of those charities whose purposes are the relief of need, the charities' procedures must ensure that charitable aid, funds and activities are targeted and delivered to those they intend to assist on the basis of charitable need. It may be possible to further limit those benefiting by some other criteria but this will depend on the charity's specific purposes and policies.

## 'Know your beneficiaries' in practice

The 'know your beneficiaries' principle does not mean a charity providing soup kitchens or emergency aid to people in an area affected by drought, natural disaster or poverty who are clearly in need of assistance, have to ask for and check identification. The circumstances will be such that they know people coming to the charity for aid are clearly in dire need and qualify for assistance. Trustees would not need to take any specific action to comply with these principles, unless specific concerns arose (see section 6.3).

For some charities offering services to the public or large groups of people, they need to identify which beneficiaries they are providing services to and take their personal details. For example, a community centre charity may hire out the centre for various activities to some of its beneficiaries. Such charities need to take enough details to know who is hiring the rooms in the community centre, confirm the booking and contact them if there is a problem. Further details may be required, in some situations, for example, to comply with insurance conditions. It is unlikely that further steps need to be taken to verify the identity of these beneficiaries for the purposes of the 'know your beneficiaries' principle.

This 'know your beneficiaries' principle is more likely to directly affect other charities which restrict access to services or activities to a certain number of beneficiaries. The main reasons they need to know the identity of individual beneficiaries and gather further details about them is to:

- ensure they qualify for any conditions or criteria which apply (for example, they may need to be elderly or have a registered disability to benefit from a charity whose services are designed to assist people with a disability or who need assistance because of the effects of old age)
- be able to provide services to them (for example, to arrange for home help support, the address and details about the identity and personal circumstances of the beneficiary will be required to contact them to arrange for the services or activities, and perhaps to be able to help claim financial assistance to pay for the services)
- help make a decision within the discretion of the trustees about which beneficiaries to select from a pool of eligible people where there are a limited number of services or activities to be provided by the charity.

## 6.2 What do trustees need to do for 'know your beneficiaries'?

### The short answer

Trustees have a duty to ensure that their charity's funds are used for its beneficiaries, so it is important that trustees are clear, in a general sense at least, about who the beneficiaries are. The amount of detailed knowledge at an individual level will depend upon the activities of the charity and the number of beneficiaries, so a common sense approach is required.

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### In more detail

Where decisions are made regularly about selecting which particular individuals receive services or support from a charity, trustees need to take reasonable and appropriate steps to ensure that:

- they know who those individuals are
- where the risks are high, appropriate checks are carried out
- it is appropriate for the charity to provide assistance to them, both in terms of their meeting any eligibility criteria and there being no concerns that the charity's assistance will not be used as intended

## Selection criteria

To help with this and ensure consistency and fairness and other elements of good decision making, it is good practice for trustees to have clear selection criteria, ideally set out in a document or policy. It is also good practice to ensure they keep sufficient details of and a record of the decisions made and process used.

Key elements of this good practice are likely to include:

- having clear selection criteria and a process which is informed by sound risk assessment and management - this may include making clear when an individual cannot qualify or be provided with support; it may include specifying what key information you may ask someone to supply when asking for assistance
- recording these criteria in a policy or in written form
- making the selection criteria available publicly, and ensuring that applicants, communities the charity supports, funders including perhaps local authorities where relevant are aware of these
- ensuring where you provide individual services to large numbers of people, you keep adequate records of those individuals, households or groups once they have been identified so you can easily check up on any problems
- ensuring there is a clear and documented process for dealing with any disagreements, disputes or conflicts regarding the identification and selection process or those who have or have not been successful
- safeguards to ensure that there are no inappropriate links or relationships between applicants and those who are deciding whether to approve their applications - also, that any possible conflicts of interest are effectively managed through policies including proper record keeping

Participatory methods- selection processes involving people and groups in the community, together with a charity's local delivery partners - are sometimes used. This local knowledge may provide valuable information in ensuring beneficiaries are genuine and appropriately selected.

Again, when obtaining and recording personal records, charities must comply with the Data Protection Act 1998 which provides a framework to ensure that personal information is handled properly and in accordance with the rules on data protection.



### 6.3 How can trustees identify suspicious situations?

#### The short answer

Trustees and their staff will normally be aware of the type, frequency and scale of applications or requests for charitable assistance. Using this knowledge they should identify the areas of risk and implement suitable safeguards.

#### In more detail

Trustees should be alert to the risk that some people abuse charities by making false applications to the charity for grant funding or for individual assistance, including creating beneficiaries that do not exist. People who may appear to be legitimate beneficiaries may make requests for support they do not qualify for or need. They may use the charity's money or other support for unlawful or inappropriate purposes or pass it on to others who may not be truly in need of it or may use for those purposes.

## Increased risk of abuse

The risk of abuse may be greater where, for example:

- a charity provides financial assistance, services or support on the basis of a certain sum of money per beneficiary and the numbers are relatively high
- a charity provides services to large numbers of beneficiaries, where it may be easier to disguise additional beneficiaries
- a partner is in receipt of funds from a number of different charities - there is a risk of double-funding, particularly where contributions are being made to costs which are not tangible or so easy to verify

Other suspicious indicators may include:

- signs that people may have been placed on distribution and aid lists by providing kickbacks and bribes to officials
- beneficiary lists that may be fake or have unusual characteristics - trustees should be alert to the risk that lists of qualifying beneficiaries have been manipulated, those who are not in need may exploit the situation; lists may contain multiple manual corrections, multiple names may appear, some may claim more family members than they have to receive more financial or other assistance
- evidence that third parties have demanded payment for recommending or nominating beneficiaries
- larger than normal beneficiary lists
- fake or suspicious identity documents
- beneficiaries with identical characteristics and addresses or multiple identical or similar names and signatures
- unexpectedly low beneficiary numbers - there should be systems for checking beneficiary numbers, as this may indicate fraud/theft of funds
- rounding up of beneficiary numbers
- discrepancies between budgeted needs and payments requested

For further advice about the risks for charities operating internationally and where the risks are higher because terrorist and criminals are known to operate (see section 11.5).

## 6.4 What do trustees need to do if they identify a suspicious situation?

### The short answer

If trustees suspect a crime has been committed or the charity's money is being used for illegal purposes, they must report the suspicious activities to the police and appropriate authorities. Serious incidents should also be reported to the commission under the **reporting serious incidents regime** via **RSI@charitycommission.gsi.gov.uk**.

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### In more detail

Charities should have policies and procedures in place, both to ensure that their trustees, staff and volunteers are aware of this risk, and to ensure that trustees and/or senior staff are alerted to any suspicious situations.

A charity's responsibility is not to investigate or determine criminality. Trustees should carry out good due diligence and take enough reasonable steps to satisfy themselves their beneficiaries are genuine. As stated previously, where trustees do suspect criminal activity, appropriate reports must be made to the relevant authorities; if reporting to the police, trustees must obtain a crime reference number.

## 7. Working with partners and protecting the charity

### 7.1 What are the options?

#### The short answer

There are a number of different ways in which a charity may want to carry out its work. This is a matter for the trustees to decide. They need to assess the risks and what works best for their charity.

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#### In more detail

There are a number of different ways in which a charity may want to carry out its work. These may include the following:

- carrying out and supervising the work themselves, using their own staff and volunteers

Charities may use their own delivery infrastructure and staff and volunteers to control and direct resources to carry out charitable work and activities. Charities may decide to expand their operations to respond to changing needs or to scale up impacts. This may involve establishing a presence in new areas, opening additional offices or redeploying or recruiting new staff, locally and/or internationally. There will clearly be management and budgetary implications for supervising and supporting additional staff and dealing with increased costs and volume and complexity of financial transactions for aspects such as office and staff accommodation, payroll, transport and communications.

Choosing to expand the charity's operations is not risk free and trustees must ensure they maintain sufficient oversight of the process and ensure that the risks are properly assessed and managed. Trustees will need to be satisfied that the charity has the capabilities and the internal controls to undertake the expansion, complying with local and charity law, and that this is properly monitored, reviewed and adapted according to evolving risks.

- carrying out and supervising the work themselves but using local representatives or individual agents to assist them where they do not have a local presence

Agents and local representatives may be individuals or organisations who agree to carry out specific activities on the charity's behalf. A charity often uses agents when it cannot send its employees or volunteers to a particular region to carry out an activity.

In common with all charities with a regional structure, where such duties have been delegated, checks and controls are necessary to ensure that they are carried out properly and in accordance with the charity's instructions. For example, local representatives may be authorised to expend up to a certain amount without the prior permission of the charity.

- working in collaboration with and alongside other organisations

Combining resources with other charitable and non-charitable groups working in a particular area can be a cost-effective and efficient way to achieve a charitable purpose. Collaborative working can cover a wide range of activities. It can include networking, sharing of information and membership of associations, groups or federations, or more formal arrangements such as joint ventures involving contracts or memoranda of understanding between charities and other organisations.

- giving grants to or using local NGOs and other delivery agents to carry out charitable projects

Charities often operate through local partners, particularly those charities operating internationally, rather than establish their own delivery infrastructure in the local area of operation. Working through and with a local NGO or partner can be an effective way of delivering significant benefits direct to a local community or area. It can support the development of local capacity, target resources to where they are most needed, and facilitate the reciprocal transfer of knowledge and skills. Local partners and delivery agents can bring invaluable experience, knowledge and understanding of the local context and how to operate in it, and are likely to be better placed to ensure that activities funded by a charity are delivered in an effective and culturally appropriate way. The local partner's experience and insights can directly enrich a charity's understanding of the social, economic and political dynamics existing on the ground. Equally, charities can bring wider external perspectives and knowledge, and potential technical expertise, which can enhance the working approaches and delivery of projects of the local partner.

Further information and guidance on collaborative working can be found in the commission's toolkits which were drawn up as a practical guide to trustees: **Making mergers work: helping you succeed** and **Choosing to collaborate: how to succeed**.

Charities might decide to use one or a combination of these methods. Trustees and those who work in a charity are best placed to judge which approach is likely to be most effective in delivering successful outcomes in line with the charity's purposes, taking account of the risk assessment and steps they need to take to manage the risks.

## 7.2 What do trustees need to do?

### The short answer

Trustees need to decide what working relationship will most effectively deliver charitable services (taking into account the type of service and the location of the beneficiaries). They need to satisfy themselves about the integrity and reputation of the partner and their ability to deliver to an acceptable standard.

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### In more detail:

Whatever method is preferred, when working with partners, trustees:

- must carry out appropriate and proper due diligence on individuals and organisations that the charity gives grants to or uses to carry out charitable projects and help deliver its work – this involves the trustees assessing the risks to ensure that those partners are suitable and appropriate for them to work with; for further information, see section 8 of this chapter
- should also consider whether any arrangements they make will need to comply with procurement requirements - sometimes additional compliance will be needed due to the terms of grant funding the charity receives from its own donors
- should properly manage the working relationship with the partner:
  - the charity's and the partner's goals, aims and ways of working should be compatible
  - entering into the arrangement must be in furtherance of the charity's purposes – trustees should ensure they have reasonable assurance that the partner is capable of delivering the proposed activities or services and has in place appropriate systems of control

- it is good practice for an agreement to be drawn up with partners for significant projects or long term relationships, setting out what the arrangement is, when any project or work should be delivered by and how and what happens when the arrangement is comes to an end - this helps protect the charity's position; the agreement would normally be clear about who has responsibility for what actions, how payment and financial matters of the work will be managed and reported on, and what happens should any targets not be met or the project not be delivered (see the outline partnership agreement, **tool 10**)
- ensuring it is clear how the relationship with the partner will work on a day to day basis and how on a practical level the charity will engage with the partner
- should ensure when using local representatives and agents:
  - the scope and extent of duties and responsibilities delegated is made clear and appropriately documented
  - they are given clear instructions and know what is expected of them and what procedures the charity needs them to follow - this may mean they need to see the charity's procedure manuals, and the charity ensures they understand what they mean
  - clear limits on spending by local representatives have been set where appropriate
  - they know what authority they have to make commitments and spend money on behalf of the charity and how they need to report and account for this
- must ensure appropriate and regular monitoring is carried out to ensure charity funds reach the intended beneficiaries and have been properly applied (see the 'monitoring' section of this chapter for detail); this includes taking appropriate and reasonable steps to verify the proper end use of the charity's funds where these are provided to partners (see section 10.5)

Trustees need to remember that they remain responsible for ensuring the legitimate and proper application of the charity's funds even if they delegate activities and provide funding under a partnership arrangement. Whatever the nature and complexity of the arrangement between a charity and its operational partner, trustees cannot delegate their legal duty of care.

Whatever the size and complexity of the proposed arrangement, trustees should ensure that they properly consider the risks involved to make certain that these have been sufficiently considered and where appropriate managed.

## 8. Know your partner

### 8.1 What do trustees need to do for 'know your partner'?

#### The short answer

As with the other 'know your' principles, the core elements of due diligence are taking reasonable steps to ensure the trustees:

- 'identify' - know who you are dealing with
- 'verify' - where reasonable and the risks are high, verify identities
- 'know what the organisation's or individual's business is' and can be assured this is appropriate for the charity to be involved with
- 'know what their specific business is with your charity' and have confidence they will deliver what you want them to
- 'watch out' for unusual or suspicious activities, conduct or requests

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#### In more detail

The 'Know your partner' principle applies to all close partner work including when using local individual representatives and agents to assist a charity, for close collaborative work with other organisations and when using local NGOs and partners to deliver projects and elements of the charity's work on its behalf.

Due diligence of partners is not just concerned with whether charitable money actually reaches the place, people and purpose intended. Trustees have a duty to manage their charity's resources responsibly and avoid exposing its assets, beneficiaries or reputation to undue risk and to protect them from harm. Due diligence therefore extends to considering whether a partner is appropriate and suitable for their organisation, (being a charity), to work with. It also includes trustees' safeguarding<sup>1</sup> responsibilities to protect children and adults at risk with whom its partners comes into contact.

Trustees should have reasonable assurance that the partner is capable of delivering the proposed activities or services and has in place appropriate systems of control, which include adequate safeguarding policies and procedures. Charities whose partners' activities involve contact with children or adults at risk should carry out appropriate due diligence on the partner organisation.

A charity must not provide funding or support to a partner organisation that exposes beneficiaries to activities which directly, or indirectly, promote terrorism or to the risk of radicalisation. This is so, even if the charity's funding or support were used for legitimate humanitarian aid or other charitable activities. Aside from the risks of committing criminal offences under UK legislation, this is also likely to amount to misconduct on the part of the trustees in managing and administering the work of the charity.

1. The Commission defines safeguarding and promoting the welfare of adults at risk and children as:

- protecting a person's right to live in safety, free from abuse and neglect
- for children, protecting from maltreatment; preventing impairment of health or development; and ensuring they are growing up in circumstances consistent with the provision of safe and effective care; and taking action to enable them to have the best life chances

In addition, some charities, for example educational charities, will also be subject to a duty under section 26 of the Counter-Terrorism and Security Act 2015 to have 'due regard to the need to prevent people from being drawn into terrorism'. This duty is known as the Prevent duty and it applies to 'specified authorities' that are described in Schedule 6 of the Act. More information on the Prevent duty can be found in the Compliance Toolkit Charities and Terrorism.

Safeguarding is a key governance priority. Therefore any failure by trustees to carry out adequate due diligence of the charity's partners to ensure they adequately manage risks to vulnerable groups, would be of serious regulatory concern to the Commission.

The higher the risks or the more significant or substantial the work or partnership, the more steps for due diligence trustees will need to take (See 3.5). Trustees need to be alert to any signs that the charity's funds will not be properly or legitimately used by partners.

Due diligence is also an opportunity for the charity to check the partner has the operational capacity and capability to do what the charity wants it to do and the partner fully understands the aims and parameters of the project. This aspect is not a legal requirement but is good practice.

Due diligence will usually involve judging the quality and completeness of the initial information obtained and then deciding whether further checks or enquiries are necessary.

Due diligence steps are likely to include:

### **Identify**

This involves obtaining the key details about who the partner is, where it is based and who the charity will be involved with. These details are likely to be required in practice anyway to arrange for payment of any funds to the partner.

### **Verify**

Where the risks are high, trustees will need to carry out further due diligence, taking steps to verify the identity of the partner and further assess the risks. This may involve checking the legal status of the partner - is it registered as a company and who owns it for example and is it appropriately registered with another regulator? If it's a charity or NGO, its registration and details can usually be checked with the relevant charity regulator, eg in England and Wales, via the register of charities. Good due diligence in higher risk situations may also involve obtaining references.

It will be for the charity to decide when these checks need to be carried out. For example, if awarding grants to partners to deliver projects, then the trustees might decide that additional verification checks will be necessary only after the list of potential partners has been narrowed down, but before any funding is paid.

### **Know what their business is**

This involves knowing what the partner's business is and being assured they are an appropriate partner for the charity to be involved with.

Due diligence steps should involve an assessment of a partner's credentials and reputation. The fact they are registered with another regulator may provide some level of assurance.

Sometimes risks can be identified from information in the public domain (sometimes referred to as open source checks). This would include, for example, information on the partner's internet site or information available through internet search engines. This may reveal information about the partner's purposes, its history and previous work.

Care should be taken about how reliable public information is, especially media reporting. This ought to be considered on a case by case basis taking into account, where the information has or is likely to come from, and whether the reporter is likely to have a certain point of view about the partner for a particular reason.

Some further questions for trustees to ask themselves include:

- is the information from an original source or repeating allegations others have made?
- how credible is the reporter?
- were any allegations investigated and/or proven?
- how old is the information?

An examination of a partner's annual accounts and governing document may also provide useful information. Some organisations are legally required to put their accounts and annual reports into the public domain, or to provide them on request.

### **Know what the partner's specific work is with your charity**

It is important, particularly in assessing grants and projects to be funded by the charity, to ensure the trustees are clear on and have reasonable assurances about:

- what will be delivered and how - what exactly is the project - how easy will it be to monitor its delivery?
- whether the partner can deliver what is required - has it the capability and capacity to deliver and on time?
- the partner's expertise and skills in this area - what history and track record does it have?
- whether the partner has the management and technical capability and capacity to undertake this along with its existing commitments
- the cost of the project, what the charity's money is going to be spent on and how it is going to be used

This 'know your partner' checklist contains some ideas and questions trustees may want to or need to consider (see **tool 8** and **tool 9**).

A partner may have one or more agreements in place with other funding organisations. Where the partner would be taking on significant additional project delivery commitments when entering into a new agreement, the charity should assure itself that the partner is financially stable and has a sufficiently robust infrastructure to deliver the project and is not over-stretching itself. In some circumstances where a partner may be funded by a number of different organisations, the charity may also want to explore with those other organisations, ways in which the reporting requirements placed on the partner by all the funding parties could be streamlined or consolidated, in order to reduce the reporting burden and allow the partner to use its management resources as efficiently as possible.

## **8.2 How many enquiries need to be carried out?**

### **The short answer**

Trustees need to assess the risks, taking into account the project's location as well as its scope and nature. Using this information, trustees will be able to determine the type, number and depth of due diligence checks on the prospective partner.

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### **In more detail**

It is for trustees to decide the level of due diligence to carry out and what type and sorts of checks they need to undertake. The nature and extent of due diligence checks should be proportionate to the risks involved from the project and entering into any new relationship or extending an existing one.

These include the risks present in the area where the partner is operating and the scale of the funding involved in the proposed arrangement. Where the risks are higher, the more in-depth the checks will need

to be (see 3.5). If you know that the partner is from a country or operates a business outside the UK, about which public concerns have been raised, then the trustees should take more steps to ensure that working with the partner is appropriate and they will deliver.

In high risk scenarios, trustees may want to seek professional advice. This is because if trustees do not take adequate steps to check their partners according to the level of risk, they will not be able to properly discharge their duty to protect the charity.

Trustees should keep a written record of due diligence processes and the results which informed their decision making. This should include the checks carried out and the results and conclusions of the assessment on a partner. The trustees should document the risks identified from the assessment together with the actions they consider necessary to properly manage the risks arising from entering into a partnership arrangement.

Trustees may also want to consider publicising or making clear that due diligence checks will be carried out on partners. This may act as a deterrent against those who may wish to abuse charities. Some charities may want to consider going as far as making clear that information may be shared with the police and other agencies for the purpose of detecting and preventing abuse and criminal activity.

### **Case Study**

The importance of a charity carrying out due diligence and knowing about its partner was highlighted in a particular Charity Commission investigation. The commission found that the charity had an agreement to hand over all its money to a foundation based in Europe. The European foundation was associated with the UK charity but was legally separate from it. The investigation was concerned that the trustees of the UK charity did not have sufficient records or controls over how its money was being spent by the European foundation.

The ability of the UK charity to operate independently and manage conflicts was made more difficult because 2 of its 3 trustees were also 2 of the 3 directors of the European foundation.

The investigation decided the agreement was not in the best interests of the UK charity and seriously reduced its independence. The agreement was cancelled and 2 of the UK charity's trustees resigned and were replaced with new trustees who had no involvement with the European foundation. The UK charity's trustees were then able properly to account for and apply its funds.

## **8.3 How can trustees identify suspicious situations and serious concerns?**

### **The short answer**

Due diligence will help trustees to identify potential risks so that they can build in appropriate and proportionate safeguards. The effectiveness of the safeguards can then be monitored and any necessary adjustments made (see section 10).

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### **In more detail**

The risk of abuse may be greater where, for example:

- the project proposal is vague or lacks adequate financial or technical details
- the structure or nature of the proposed project makes it difficult to identify the partner and verify their identity and details
- the proposals include delegating work to other unknown partners or newly formed organisations

- it is difficult to contact the partner at their main address, or their telephone numbers are not working, or the partner always insists upon contacting the charity and not the other way round
- the project involves unusual payment mechanisms, or requests for cash, or for money to be paid into an account not held in the name of the partner, or in a country in which the partner is not based and not where the project is being carried out
- the partner may be, or may have involvement with, politically exposed persons (PEPs) (see technical terms used)
- partners request unnecessary or unusual levels of privacy and secrecy
- the partner cannot demonstrate much previous project delivery and it is difficult to get independent references to vouch for it

For further advice about the risks for charities operating internationally and where the risks are higher because terrorist and criminals are known to operate (see section 11.3).

## 8.4 What do trustees need to do if they identify a suspicious situation?

### The short answer

If trustees suspect that a partner may be bogus or they are suspicious about them or their work they should seriously consider not taking forward the proposed project with the partner.

If trustees suspect a crime has been committed or the charity's money or assistance is being used for illegal purposes, they must report their concerns and suspicious activities to the appropriate authorities.

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### In more detail

If as a result of due diligence checks there is information to suggest there are significant risks to the charity or that a relationship with the partner would expose the charity's assets or reputation to significant risk, then the trustees need to consider not engaging with that partner or finding other ways to manage the risks.

The nature and extent of the risks will determine whether the right thing to do is to cease working with the partner and on the project or whether work can continue providing the risks are effectively managed.

Charities should take steps to ensure that its trustees, staff and volunteers are aware of the risks and have clear policies and procedures in place to ensure that trustees and/or senior staff are alerted to any suspicious situations.

A charity's responsibility is not to investigate or determine criminality. Trustees must carry out good due diligence and take enough steps to satisfy themselves the partner is genuine. If they suspect a crime has been committed or the charity's money or assistance is being used for illegal purposes by a partner, they must report their concerns and suspicious activities to the appropriate authorities, including the police and the commission. If trustees report to the police in the UK they should ensure they obtain a crime reference number from them.

## 8.5 Is there a legal requirement to enter into a written agreement with partners?

### The short answer

There is no specific legal requirement to enter into a partnership agreement, but it is the main way, particularly where risks are high, that trustees can show they have properly protected the charity's legal position and have acted in its best interests. In some cases, unless trustees ensure one is in place, they may not be able to show they have met their legal duties. It is, however, good practice to have a partnership agreement.

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## In more detail

While partnership arrangements may be based on mutual trust, trustees are under legal duties to act in the best interests of the charity and protect charity property. Trustees must ensure that their charity's accounting records are sufficient to show and explain all the charity's transactions. Ensuring that the terms of the partner relationship are made clear in writing before a project commences, will help with problems if they occur later on.

Once a decision has been made to work with a partner, before any funding is transferred, a charity should, as a minimum good practice, ensure that there is an agreement between the charity and its partner about how the partnership will work, how much funding will be provided by the charity, when any work will be delivered by the partner, how results will be demonstrated and how reporting and monitoring arrangements will work.

If the amount of funding involved is very small, the arrangement is minor or insignificant and/or with very low risks involved, it may be proportionate not to have a written legal agreement. In other cases, the trustees either should, or in some cases, must ensure they have one otherwise they may be unable to demonstrate that they have discharged their legal duties.

A partnership agreement is usually a binding legal contract, although it will depend on how it is drafted. It usually sets out the nature of the relationship between a charity and the partner and outlines respective roles and responsibilities. Trustees may need to obtain professional advice before signing a legally binding agreement and should ensure it is signed by someone with an appropriate level of authority. The charity should also check the person signing the agreement on behalf of the partner has legal authority. The decision to enter into the agreement should be documented, then appropriate monitoring controls agreed upfront.

The amount of funds being provided by a charity to a partner, eg as grant funding, must (as a minimum) be clearly set out. It is good practice to ensure the agreement sets out the payment provisions and reporting requirements needed, as well as receipts/ records, and necessary accounting and audit requirements.

The agreement would also normally set out the expected outcomes and deliverables for the project with timelines and key milestones.

If the charity is subject to specific obligations about how it applies its funds, it will be important to ensure that the requirements placed on partners include these. Such requirements might, for example, relate to grant-related procurement issues, reporting on project progress, and any restrictions on the use of funds. Trustees may find it difficult to enforce compliance and may expose the charity to legal liability, unless its partners are required to meet pre-agreed standards.

Depending on the circumstances, it may also benefit the charity to identify the partner's needs for guidance and support, and to plan how best to assist. Trustees may wish to consider including extracts of key charity policies or procedures within the partnership agreement, as these can clarify expectations and obligations.

As an example, **tool 10** contains some requirements to consider including in a partnership agreement.

## 8.6 Case studies - know your partner

A UK charity was set up to provide education and other charitable benefit for children in Africa. It entered into a partner relationship with an African NGO which provides schools and homes to local children, many of whom are orphaned and destitute. There was no written partnership agreement. The UK charity provided substantial funding to the African NGO but did not undertake any charitable activities in Africa itself.

The African NGO employed a number of volunteers, some of whom were UK-based and applied having seen the NGO being featured on the charity's website. The charity did not play any direct part in the recruitment or appointment of volunteers but merely signposted them to the African NGO which carried out the selection process itself.

While working in Africa, one of the UK volunteers was assaulted by an employee of the NGO. This led to a complaint to the commission about the charity's alleged failure to provide adequate warning about the risks to volunteers and to put appropriate safeguards in place. The complainant also said that groups of children in the care of the NGO periodically visited the UK and were placed by the charity with families who had not been DBS checked.

The commission found that concerns had previously been raised about the safety of volunteers working with the NGO, but the trustees of the charity were unaware of these. The commission also found that the charity had not ensured that families hosting the visiting children should obtain DBS clearance.

The commission concluded that the charity trustees had not carried out sufficient due diligence with regard to the choice of partner NGO. Although the charity's trustees are not responsible for the recruitment of the NGO's staff, more detailed background checks would probably have revealed past incidents and enabled the charity at least to warn volunteers of the risk. They would also have strengthened the justification for a written partnership agreement into which suitable security precautions could be built.

On the commission's advice, the trustees have also introduced strict procedures to ensure that host families undergo DBS checks before children are placed with them.

A UK charity was part of a world-wide federation of NGOs which had its administrative headquarters in Europe. The UK charity was legally independent and self-governing, but it had entered into a formal agreement under which it sent all of its net income to the federation headquarters. The federation's managers then distributed the funds to various humanitarian projects around the world.

A substantial proportion of the UK charity's income was generated by posting appeal literature to members of the public, usually accompanied by a small free gift, seeking donations in return. The commission had received complaints about the emotive and distressing nature of the literature, and concerns about the expenditure of charity funds on free gifts.

The commission concluded that the federation was in effect a partner of the charity, but in agreeing to hand over the charity's income the trustees had restricted their discretion and compromised the charity's independence. It appeared to the commission that the UK trustees had not carried out adequate due diligence in the choice of partner or the terms of the operational relationship.

The commission also concluded that although the trustees had taken conscious decisions to make the appeal literature hard-hitting and to send out free gifts they had not fully considered the negative public impact that this strategy might have and the reputational damage it was likely to cause. The commission felt that the trustees had not adequately considered donor reaction at the outset, and had failed to monitor it during the course of the appeals.

## 9. Monitoring

### 9.1 Why is monitoring important?

#### The short answer

Monitoring is important to ensure that trustees are able to account for the proper use of the charity's funds and that they maintain donor confidence.

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#### In more detail

It is important that donors and the public have confidence that money they have donated to charity has been used appropriately and properly. Trustees are under a legal duty to ensure funds are used only in furtherance of the charity's purposes and are legally responsible and accountable for their proper use. They must be able to demonstrate that funds have been used for the purposes for which they were intended. This means they need to take reasonable and proper steps to ensure that any money or resources have reached their intended beneficiaries. Monitoring is an important way of ensuring this is the case.

Drawing up robust monitoring processes, and recording and implementing them will help charity trustees ensure that funds are adequately protected from abuse, misuse or other loss, and are being put to their most effective use. For more detail explaining trustees' legal duties and responsibilities for monitoring (see section 2.2).

Monitoring may help the trustees identify occasions where the project work has gone wrong or not been delivered in the way the charity expected. It may also help identify situations where people other than the intended beneficiaries have taken advantage of charitable services or activity. Where it is well known a charity carries out robust monitoring, this may act as a deterrent, helping to prevent abuse of its funds in the first place.

### 9.2 What is monitoring?

#### The short answer

Monitoring may take a variety of forms depending on the nature of the charity's work, the particular project and amount of charitable funds involved. It will almost always include steps to verify the proper end use of funds.

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#### In more detail

Monitoring will almost always include some steps to verify that funds have been passed to the partner and verify their proper end use. But monitoring is more than that. It is about ensuring effective delivery and promises made by the partner to the charity are met. Ensuring this is the case, in turn protects the trust and confidence a charity's donors have in it. Even in lower risk situations, monitoring will help to verify that the project matches the initial low risk assessment, and if not, can prompt a timely re-assessment for the partner.

Monitoring will take a variety of forms depending on the charity's work, the particular project, the amount of charitable funds involved and the outcome of a risk assessment. However, it will usually involve steps aimed at ensuring:

- the charity's funds can be accounted for, that there is an audit trail showing the expenditure of funds by the charity, checking the funds were received by the partner and, if the partner forwarded those funds on, that there is an audit trail to show this
- the partner has actually delivered the project and charitable work expected
- the charity's funds have been used for the purposes for which they were intended, and for the beneficiaries identified
- that any concerns that need to be dealt with are identified
- the partner continues to be appropriate in all respects for the charity to work with

Monitoring may also be broadened to fulfil other purposes, for example:

- assessing the impact and value of the project and charitable work
- assessing whether the charity's funds are being put to their most effective use
- as a tool to gauge customer and stakeholder satisfaction with the charity
- helping to benchmark standards across a number of the charity's projects
- helping to assess and review risks to the charity

For a variety of reasons monitoring may not be easy and may present practical challenges. This is particularly so in certain parts of the world where access to the areas in which the charitable work is being carried out may be restricted.

### 9.3 Are there additional requirements for charities that send money overseas?

#### The short answer

Yes. Both charity law and the requirements of HMRC, including the provisions of Finance Act 2010, mean that additional steps will need to be taken by charities operating overseas.

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#### In more detail

Further information can be found in section 11.6.

### 9.4 What monitoring steps must trustees take?

#### The short answer

Some form of monitoring will usually be required. However, what an individual charity must do, as a legal requirement and should do as good practice, will depend on the circumstances.

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#### In more detail

The extent and nature of the oversight and monitoring requirement will therefore depend on a number of factors, including the risks involved in the charitable work and project. Other relevant factors include:

- the experience the charity has in carrying out this work
- whether its own staff or trustees are experienced in and/or able to carry out the monitoring required

- how robust and strong the charity's normal internal and financial controls are
- whether the charity has an established internal audit function that can carry out project monitoring
- whether the charity has accountants which independently audit or examine the charity's funds and projects
- whether the charity's own grant funders will carry out their own monitoring or auditing of the project
- the capability, capacity and track record of the partner in both delivering results and properly accounting for and reporting on the use of funds
- the size and complexity of the project
- the amount of the charity's funding involved compared to the charity's size
- the amount of the charity's funding compared to the total cost of the project and if it is overseas, the relative value of this in the country concerned
- if it is known that an overseas partner does not or cannot use a formal banking system and may use for example, local unregistered Money Service Businesses (see technical terms used) or cash couriers
- over what period the project and funding is being provided
- the extent and nature of the charity's existing relationship with the partner
- the nature and strength of the partner's own governance, risk management and internal controls
- whether ensuring there are proper audit trails may be sufficient evidence that the funds have been used for proper purposes
- whether monitoring is required at different stages of the project or just at the end
- whether the monitoring information required will be generated manually or will form part of routine period-end computer reports
- how much it will cost in terms of money and staff resource

A risk-based approach allows for flexibility in deciding how often and what methods a charity uses to ensure it meets minimum standards, and the trustees discharge their legal duties. The risks that some partners and projects give rise to may only become fully evident once a relationship with a partner has begun, which reinforces the importance of monitoring.

The most effective monitoring systems will usually use a variety of different methods. These systems should be in accordance with the monitoring provisions in any partnership agreement and should be regularly reviewed (see outline partnership agreement at **tool 10** in the annex). Choosing how a charity monitors a project will very much depend on each individual circumstance and the practical issues involved. Where there are higher risks associated with an activity, (for example, when operating overseas in areas where financial and other crime is known to be a problem), this will probably need to be reflected by increasing the frequency and intensity of monitoring. For guidance on factors likely to make the risks higher for monitoring see section 3.5. There may be some instances where it is dangerous or extremely challenging to effectively monitor work being carried out, for example providing humanitarian aid in a disaster or conflict zone. In such instances, trustees will need to reflect the risks involved in developing a practical monitoring process.

The risk based approach recognises that not all partners and financial transactions need to be monitored in exactly the same way. However, if as a result of monitoring, suspicious circumstances arise and non-compliance may have taken place, then there will be much less flexibility in how trustees deal with this.

## 9.5 What is meant by verifying the end use of funds and what monitoring steps does it cover?

### The short answer

Verifying the end use of funds is the process of ensuring money has both physically reached the partner and that it has been spent by them properly and as the charity intended.

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### In more detail

The key elements of verifying the end use of funds usually include:

- ensuring there is an audit trail for the movement of funds from the charity to the partner
- ensuring there is an audit trail and proper records (eg receipts and invoices) that show the partner has spent the funds on legitimate goods and services
- some form of proactive monitoring by the charity to be satisfied that the funds were actually used for the purposes intended, with appropriate reporting by the partner to support this

It is important to stress that verifying the proper end use of funds is not just about ensuring a paper trail for the flow of funds is in place. For example, a charity may fund a project to build a local school and hospital for a poor community. Although audit trails, receipts and records may show that the charity's funds have been spent on buying bricks and building materials they would not necessarily show that the materials have been used to build the hospital and school. They might, for example, have been diverted to build property for the families of local criminals. This is why some form of proactive monitoring by the charity and reporting by the partner are important.

As with the 'know your' principles, the frequency and intensity of these processes will depend on the risks and a number of other factors.

A charity should be able to show that it receives accurate reports that enable effective control and oversight of the use of its resources. Reports may be linked to key aspects of the project cycle such as periods of funding tranches, project milestones and deliverables, and project completion. The detail and frequency of monitoring and reporting should be proportionate to the level of risk faced.

## 9.6 What other issues affect monitoring?

### The short answer

Monitoring must be effective and credible. It is important that partners have confidence in the charity's monitoring processes and its credibility. Ensuring it is objective, staff are competent, and any conflicts of interest are dealt with are all important.

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### In more detail

Effective monitoring should be carried out by competent staff with the right skills and expertise to do a good job. Trustees should consider, for example, whether a technical expert or someone with financial expertise should carry out the monitoring on a particular project.

The most effective monitoring usually involves some degree of independence and impartiality. It may be important to ensure that the charity's staff who monitor the project are different from those who act as the point of contact with the delivery partner. For example, trustees should consider whether the charity's local office or branch or the national/head office should lead the monitoring. It is also important that any conflicts of interest are managed and dealt with properly. Potential conflicts of interest may arise between the personnel in the charity and the partners, or with the bodies or people external to the charity carrying out monitoring. It is important that monitoring is, and is seen to be, objective and unbiased.

It is important that the people carrying out the monitoring appreciate the context in which the project is being carried out. Monitoring needs to be appropriate for the charity's needs, the project, the country and the risks involved.

Trustees need to think about what the results of the monitoring look like. Will it be in the form of a written report? If not, the charity will need to keep a record of monitoring work that has been carried out with a sign off/authorisation sheet. Will the partner have a chance to comment on the results and how will the charity deal with any disagreements? Trustees also need to remember that any issues which arise as a result of monitoring will need to be taken up with the partner and dealt with. It is important to both the partner and the charity that the findings are acted upon.

## 9.7 What should monitoring cover?

### The short answer

To have any value, monitoring processes must be effective and credible. As well as verifying that the expenditure is correct, they should be capable of identifying system deficiencies or breakdowns at an early stage so that corrective action can be taken. If it is known that a charity's monitoring systems are robust and effective it may act as a deterrent, helping to prevent abuse of funds in the first place.

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### In more detail

Good monitoring systems will enable trustees to be confident that they can account for the proper use of their charity's funds. The monitoring steps that trustees must take as a legal requirement, and should take as good practice, will depend on the circumstances.

A key objective of monitoring is to check the proper end use of the charity's funds, whether the benefit is delivered by the charity itself or through one or more partners. There are a number of ways in which trustees can monitor the delivery of charitable services and the expenditure of charitable funds. The choice of methods will depend on a range of factors, including the nature of the charity's work and the involvement of operational partners. Trustees should implement monitoring systems that meet their charity's specific needs and are proportionate to the risks. Charities operating internationally may need to build in additional checks.

Monitoring as a minimum will usually cover:

- ensuring there is an audit trail for the movement of funds from the charity to the partner and project
- ensuring there is an audit trail and proper records (eg receipts and invoices) that show the partner has spent the funds on legitimate goods and services relevant to the project
- some form of proactive monitoring by the charity to be satisfied that the funds were actually used for the purposes intended and that there is appropriate reporting by the partner to support this

It is important to remember that monitoring should extend beyond checking paper trails. In addition, it is important for trustees to be aware that paper trails can be fake or distorted.

The tools include a checklist of some things to think about when monitoring a project, whichever form of monitoring is required (see **tool 15**).

## 9.8 What are the various monitoring tools and options?

### The short answer

There are a number of ways in which monitoring can take place and methods that trustees might use. Trustees should ensure that the methods they choose fit the charity and its work and are proportionate to the risks involved. Achieving that balance successfully can be difficult and challenging.

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### In more detail

It is for trustees to decide which methods and techniques best fit the charity, its work and the purpose of the monitoring it needs to carry out. Some of the monitoring tools that charities use include:

- 'formal reporting by the partner' delivering the project – this could take a number of forms and the charity may place specific reporting requirements on the partner:
  - this might be regular 'verbal reporting' if the risks are low, the project is simple or short term or the situation on the ground fast evolving
  - a form of simple written 'self-certification' might be useful to ensure there is some assurance on basic checks about the use of funds – self certification can help reduce the financial and administrative burden on a charity, it also helps the charity focus enhanced monitoring on where its resources and time will be best spent relative to the risks.
  - in larger projects, for larger grants or where the risks are higher, a more 'formal report' in writing is likely to be a necessary basic step
- a report by the charity's own 'internal audit' function
- the usual reports of the charity's external, 'independent auditors and examiners of the charity's accounts' - audits and independent examinations normally concentrate on paperwork and records being in order; an assessment needs to be taken as to whether the audit or examination needs to go beyond a paper trail, if so how, and whether this will be enough for the charity's monitoring of the particular project in question
- 'off-site office based supervision and monitoring by the charity', checking paperwork and audit trails and using phone and other communication methods to verify activity on the ground
- 'on-site inspections/visits' carried out 'by the charity' -depending on the size and structure of the charity this might be part of the internal audit function or a specific step taken for a particular project; the charity's local office or branch or the national/head office might be used to carry this out -one way of ensuring standards are objective, and the assessment independent might be for offices or personnel other than the one(s) responsible for the project to carry out monitoring, inspections and visits can take a variety of forms -they may include unannounced spot checks or planned detail inspections

- 'on-site inspections/visits carried out by others', including:
  - the charity's auditors or independent examiners of its annual accounts
  - the partner's accountants or other professional advisers
  - other independent experts or consultants
  - another funder in the area, perhaps through a mutual monitoring exchange programme partnering up with other charities and NGOs
  - other local NGOs or branches of international charities if it is an overseas project
  - the charity's local representative/agent in the area
  - relying on the monitoring 'reports of other regulators' and government agencies
  - commissioning 'external consultants or agencies' specialising in monitoring and evaluation -a charity might want to employ its accountants or other specialists to carry out bespoke monitoring of a particular project; when using third parties to carry out monitoring on behalf of the charity, it is important that it is made clear what monitoring is required and by when.
  - relying on monitoring 'reports of other bodies', for example, other funders, charities or NGOs
  - 'peer or stakeholder reviews'
  - using 'benchmarking and industry standards' - trustees will know what specific benchmarks and best practice standards are relevant to their charity's work, akin to "industry standards"; stakeholder and community feedback and standards can be useful in this respect: the charity itself, if large or with a number of operations, may want to establish its own benchmarking standards for all of its projects and work which it expects all its partners to comply with
  - 'feedback direct from beneficiaries' and problems identified through complaints and concerns made by beneficiaries and the public, can be useful monitoring tools. - sometimes they may identify, for example, blockages to aid getting through and they may be the only people who could detect abuse on the ground (for example local agents taking a cut of the aid themselves or seeing local bribes taking place); where a charity is open and transparent about what its money should be used for, its beneficiaries and people working with them will be more likely to notify the charity or the partner if this is not the case -it is important to ensure the charity is clear about how such complaints are dealt with and its staff and volunteers know what to do if a concern or complaint is raised
  - 'local reporting information' can also be useful for the monitoring of projects - this may be specific, for example, that it is well known in the community the charity's goods are being sold locally in a market, or it may be general, for example, that there are reports of intimidation and corruption in the locality which pose a risk to any humanitarian projects currently being carried out

There are advantages and disadvantages associated with each of these techniques and methods. These will impact upon how much a charity can or should rely on a particular method or the results of them. The most likely combination for larger and high risk projects is likely, at the very least, to include some kind of regular off site supervision for the period of the project, including analysing reporting information coupled with an on-site inspection.

## 9.9 Can a charity carry out joint monitoring with another body?

### The short answer

Yes, as long as it puts appropriate safeguards in place.

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### In more detail

If a charity knows another charity or partner is also funding a project, the trustees may want to explore whether the charity can exchange monitoring and project information and agree to joint monitoring. Trustees need to be careful about how and when they do this, especially if they agree to do so at the bidding stage, to ensure they do not fall foul of competition law restrictions. If joint monitoring is agreed, each organisation needs to be clear about what information is being exchanged and how and needs to ensure that appropriate safeguards are in place, especially where personal data is involved.

## 9.10 Is an on-site inspection or visit compulsory?

### The short answer

There is no specific legal requirement to carry out an on-site inspection. However, depending on the risks, it may be the only way a charity can be sure that its funds have been properly used and the project delivered. In other cases, an on-site inspection by the charity itself will not be possible due to the safety risks or costs, but there may be other ways in which a charity can ensure that the project is proceeding to plan and within cost.

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### In more detail

The examination of operations on the ground in an inspection or local site visit is an enhanced monitoring tool. A risk-based and proportionate approach means that across-the-board visits or inspections of all programmes in most cases are not likely to be suitable or necessary providing other measures are in place (see section 10.11). However, where the risks are higher, (for example, a charity works in an area where corruption and abuse is known to take place, or where terrorists and criminals are known to exploit charities and NGOs), this is a higher risk situation. In these circumstances to ensure the trustees discharge their legal duties, (see section 2.2) they may need to put in place enhanced and more elaborate monitoring step, even if the cost is significant.

Sometimes site inspections/visits may be the only reliable method of ensuring that projects are taking place and the charity's money has been spent by the partner in the way expected. They can also be useful in understanding and developing a relationship with the charity's partner. However, an on-site inspection or visit may not always be possible and it may be costly to carry out.

The tools include a checklist of some questions and factors that may be useful when considering monitoring visits (see **tool 12**).

## 9.11 What are the other alternatives?

### The short answer

Trustees need to balance the costs and practicalities of on-site inspections, especially for projects in areas which are inaccessible. Sometimes the safety risks may mean a visit is not possible. However, in order to comply with their legal duty they must take reasonable steps to ensure that the charity's funds are being properly applied. There are a number of other options to demonstrate effective delivery.

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### In more detail

When on-site inspections/visits are not possible or not appropriate, as a minimum written reports should be obtained in higher risk cases. These should be supported by documentary evidence (where available) to obtain assurances that charity funds are being used appropriately. Examples of other suitable evidence might include:

- photographs and/or video footage
- self-certification by the partner and/or local agents
- feedback, testimony or references from beneficiaries and other stakeholders
- inspection of financial records, including banking statements, invoices, receipts and cash books
- minutes of key meetings and decisions
- copies of assessments undertaken by agencies and other contracted third parties

Local regulation of charities may complement the monitoring work undertaken by trustees, but it should not replace it completely. Trustees are still under obligation to be able to demonstrate reasonable efforts have been made to obtain the verification necessary from partners to account for expenditure.

## 9.12 Must trustees report back to donors and other stakeholders?

### The short answer

No. There is no legal requirement to do so against each donation made or for each project, unless a gift or grant is subject to reporting conditions and the charity agrees to do this.

However, it is good practice to make available some form of reporting on the charity's work to its donors and supporters. It promotes openness, helps demonstrate that the work is for the public benefit and helps charities develop a strong and transparent relationship with their donors.

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### In more detail

If the trustees of a charity accept a donation or grant, or enter into a funding agreement, which is subject to a condition that they must report back to the donor on its use, they should comply with this. However, there is no general legal requirement for trustees to report to donors.

Charities are subject to accounting and reporting requirements which are designed to enable the public and the charity's donors, and potential donors, to see how and where their money has been spent.

Monitoring plays an important part in giving donors confidence that their money will go to a good cause and in demonstrating the charity's funds have been used properly and effectively for the benefit of its beneficiaries. Some form of reporting on the charity's work can be very helpful. In addition to maintaining and building public trust and confidence in the integrity of charity generally, it promotes a spirit of openness and demonstrates public benefit. It will also help the charity to develop a strong and supportive relationship with its donors. It is therefore good practice to consider some form of general reporting to donors about the charity's work. Some charities achieve this through putting information on their website or through setting up emailing updates to donors so they can see progress with how the projects they have funded are developing.

All registered charities must prepare a trustees' annual report (TAR) and make copies available to the public. Charities with an annual income of £10,000 or more must send a copy of the TAR to the commission, which is then made publicly available. The TAR is a good way of reporting back to members of the public about the charity's activities and successes.

For further detailed information, see **Charity reporting and accounting: the essentials (CC15b)**.

## 9.13 How can trustees identify suspicious situations?

### The short answer

Even with good monitoring systems it is not always easy to recognise genuinely suspicious situations. Nor should trustees assume that a failure or negative outcome of an individual monitoring check amounts to evidence of serious problems. Most monitoring failures will simply indicate that there is a possible weakness in a particular area of the charity's operations or administration, and that some corrective action needs to be taken to put things right before the weakness becomes serious. However, if the monitoring process reveals serious weaknesses, or weaknesses across a wide area of the charity's activities and operations, a more rigorous response may be called for including, where appropriate, reporting matters to the relevant authorities.

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### In more detail

#### Paperwork

Signs that audit trails, financial and other records and paperwork may not be in order including for example signs that:

- invoices and paperwork have been tampered with, perhaps they have been altered in crucial aspects with handwritten amendments
- invoices and papers recording a lower than expected number of goods on them
- there is a lack of evidence to show fair and transparent tendering or procurement procedures
- invoices and papers recording a higher cost for goods or services than expected or agreed
- missing key documents or only copies can be produced, which raise suspicions perhaps because they are poor copies or because key details are illegible or have been altered
- signatures confirming receipt or payment are missing or the invoice is unsigned or undated
- receipts have been signed and dated a long time after the goods or services should have been delivered
- particularly late or early invoicing
- repeated excuses of systems crashing, losing records or paperwork not being available for inspection
- records of receipts not being on the usual headed notepaper or official receipt book of the partner, or records which are out of chronological and numbered order

- beneficiary lists that may be fake or have unusual characteristics, for example, identical characteristics and addresses or multiple identical or similar names and signatures
- larger than normal beneficiary lists, especially in an international environment during local election periods

### **Project issues**

Suspicious activities on the ground in the project may include indications that:

- relief, goods or items provided by the charity in connection with the project have been tampered with, for example packaging torn, items feel lighter in weight than expected when carried, or there is an unusual number of damaged goods which are irreparable and have to be counted as void or returned to the supplier as faulty
- equipment and materials are old, sub-standard or non-functioning, suggesting that they have not been purchased using funds recently provided for the purpose
- documents accompanying goods and items are missing
- deliveries of goods take an excessively long time to arrive
- the local community is receiving aid or assistance by other unexplained or unexpected means
- indications that local staff may be living beyond their means or staff appearing at unusual times or carrying out tasks or jobs they should not be, or other unusual staff behaviour or conduct

### **Financial**

Indications that financial aspects and transactions may be suspicious including, for example, signs of:

- unexpected currency changes or transactions, where commission has been deducted or charged or where no receipts are available
- figures in documents or records that look familiar or may be repeated
- invoices with key pieces of information missing
- sudden or increased staffing costs
- unexplained additional increases in costs for goods, especially if they appear more than the local or market rate
- discrepancies between budgeted needs and payments requested
- requests for payment to be made into a different bank account, not in the name of the partner or NGO helping on the project or where the name of account is slightly different from the name of the partner or at a different address from that previously given and upon which due diligence checks were carried out
- requests for payment in cash to be made to an unknown third party or other organisation
- requests for continued payment to people who left the organisation or partner some time ago
- payment of administration costs not appearing to relate to the project or which appear unusually high taking into account the nature of the project
- bank transfers taking longer than they would normally
- cash advances and payments that are unusually frequent and/or have not been recorded or approved
- funds are not being banked or accounted for
- infrequent and/or poor reconciliation of local banking and accounting records
- being asked to pay a local member's wages direct to someone else in the team
- payments to suppliers via cash payments to members of staff

## Other

Other signs which may or may not indicate something to take a closer look at include:

- numerous urgent requests for assistance, to be dealt with outside of normal procedures, or accompanied by requests to deploy a 'lighter touch' procedure
- requests by partners to use a particular auditor or accountant
- late reporting by the partner or reluctance on their part to submit monitoring reports, or regular resistance to receiving monitoring or audit visits
- offers for monitoring to be carried out by friends or known associates of the local partner without the need for the charity to carry out an inspection or checks on the partner themselves
- requests to use particular officials or agents in the locality for monitoring purposes
- any evidence that people may have been placed on distribution and aid lists by providing kickbacks or bribes to officials
- evidence that third parties have demanded payment for recommending or nominating beneficiaries or delivery agents
- emails from new or unusual email addresses not in the partner's domain name or from someone who is not a previously agreed contact point
- inconsistencies between narrative reports and financial claims and reports and
- monitoring reports always being about the same sites or projects

## Partner reports

When examining and relying on partner reports, trustees should be alert to the following which may be signs that something is not right:

- reports that are completely consistent with the targets and always indicate that benchmarks have been met, with little supporting information
- reports that are inconsistent with other sources of monitoring information
- inconsistency between individual reports or between listed achievements and the financial figures
- a high incidence of simple errors that may be masking more serious underlying problems
- unquantifiable opinions or excessive praise from unlisted or uncredited beneficiaries
- where there are multiple sites, services or projects being worked on, the same examples are appearing as 'success stories'

Whilst these examples might be innocent mistakes, errors or events, they might also be signs of suspicious activity.

## 9.14 What do trustees need to do if they identify a suspicious situation?

### The short answer

If trustees suspect a crime has been committed or the charity's money, assets or reputation is being misused, they must submit a report to the appropriate agencies, including the Charity Commission, via **RSI@charitycommission.gsi.gov.uk**. For more detail, see the commission's guidance on **reporting serious incidents**.

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### In more detail

Charities should have policies and procedures in place both to ensure that its trustees, staff and volunteers are aware of these risks, and to ensure that trustees and/or senior staff are alerted to any suspicious situations.

As mentioned earlier in this guidance, trustees are not responsible for investigating crimes. What they are required to do when they identify evidence of crime is to report it to the relevant authorities, including the police and the commission, and immediately take steps to prevent any further risk, damage or loss to the charity's property and reputation. This may entail a complete review of internal control systems and/or arrangements with operational partners.

Where an incident is not being taken forward by the police or other authorities, trustees may decide to take further action themselves. Appropriate action will depend upon the circumstances and the problem in question, eg if the terms of a grant or partnership agreement have been broken, remedies may include sourcing a more suitable partner for future projects, withdrawal of future grants or seeking repayment of the grant funding already paid.

It is also important for the charity to promote a culture where abuse and misconduct are not tolerated. Charity staff and volunteers should know they will face disciplinary action if they are found to be involved in abuse or misuse of funds.

## 9.15 Case studies - monitoring

1. A charitable appeal was launched in the UK by a non-charitable company to raise funds for the victims of widespread flooding in Asia. The charitable funds were kept properly segregated in their own UK bank account and there were records showing clearly how much had been received.

The company had an agreement with a local NGO in the affected area to carry out relief projects, and the charitable funds were to be released to the NGO in tranches as the projects progressed. The managers of the company were unable to visit the area regularly themselves, and relied mainly on progress reports from the NGO itself. There was no formal written agreement in place setting out the structure of the reports and the evidence of progress that was to be provided. Nor was there any arrangement to have independent corroboration of progress.

The managers of the company became concerned that the progress reports were inadequate, and that costs appeared to be too high for the work done. As a result, the release of charitable funds to the NGO was delayed and this adversely affected the relief projects.

The commission found that both the company and the NGO had acted honestly and in good faith, but the absence of a proper agreement between the company and the NGO, including arrangements for independent verification of costs and progress reports, caused delays in releasing charitable funds which could have affected the beneficiaries.

2. A charity was established to relieve hardship and distress amongst refugees in a Middle Eastern country. In response to complaints that donors were being misled into believing that they were sponsoring individual children the commission investigated the way in which the charity identified and provided charitable services to its beneficiaries.

The commission found that funds were sent to an intermediary in another Middle Eastern country and paid into his personal bank account. The intermediary was effectively left to distribute the funds unsupervised. The trustees claimed that this arm's length arrangement was necessary to prevent the identities of recipients becoming known to armed political groups who would have victimised them. However, the trustees were unable to exercise any effective control or supervision over the way in which the funds were being spent, or even confirm that they did in fact reach their intended country of destination. The intermediary did not provide any feedback to the trustees, and they did not ask for any.

There were no financial controls in place once the funds had left the charity's UK bank account, and the trustees acknowledged that they could not account for or verify the end use of a significant proportion of the funds. The trustees were unable to demonstrate that the funds were in fact reaching the charity's beneficiaries.

The commission concluded that the trustees had not carried out sufficient due diligence in the selection of the intermediary. Nor had they given any instructions to him about the detail and frequency for providing feedback and evidence that the funds were being applied in accordance with the charity's objects. The trustees neither carried out any direct monitoring of the end use of the funds themselves, nor did they make arrangements for monitoring to be carried out by another person or NGO.

## 10. Charities operating internationally

### 10.1 How do the 'know your' principles affect charities operating internationally?

#### The short answer

The legal duties that apply to trustees of charities which operate in the UK apply equally to trustees whose charities work internationally. Appropriate due diligence will enable trustees to address the risks.

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#### In more detail

The legal duties explained in section 2 apply to 'all' trustees of 'all' charities subject to the law of England and Wales, whatever their income, whether registered with the commission or not and whether or not they are based, operate or work internationally (whether directly or through partners). However, what action is reasonable or proportionate to take to ensure trustees comply with these duties will vary from charity to charity, depending on how and where they operate and the risks faced.

Charities working internationally may be exposed to particular risks inherent in the environment in which they operate, in regions and countries where the risks and challenges of operating are higher. It is often in these contexts where there is great humanitarian need.

Charities working internationally - either directly or through partners - may face different risks and should tailor their due diligence and monitoring checks accordingly. In outline, the greater the risk faced, the more action will be required to mitigate it.

Trustees must be alert to the risk of abuse and take proper and reasonable steps to ensure that the funds given to them are used for proper purposes and reach their intended beneficiaries; they should also seek to reassure donors and the public on appropriate use of charitable funds.

Further information on the particular issues affecting charities operating overseas can be found in the commission's guidance **Charities: how to manage risks when working internationally**.

### 10.2 How do trustees go about assessing risk in international work?

#### The short answer

The level of risk will be affected by a range of factors including the charity's familiarity with the country or region in which it is operating and how well it understands the laws, regulations and rules both nationally and locally.

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#### In more detail

There are no universally recognised criteria for assessing and determining risk in particular countries or geographic regions. However, regions that may pose a higher risk to charities in ensuring they discharge their legal duties and responsibilities may include:

- countries that are subject to sanctions or embargoes, for example issued by the United Nations
- countries identified by credible sources, such as FATF (see technical terms used) or the World Bank, as well as relevant national government bodies and NGOs, as lacking appropriate anti-money laundering or counter-terrorism laws and regulations - the information provided by these credible sources does not have the effect of law or regulation and should not necessarily be viewed as an automatic determination that something is of higher risk, but it does provide current information about high risk jurisdictions

- regions known to be vulnerable to significant levels of corruption and criminal activity or with regular incidence of criminal activity
- areas dealing with instability, conflict or other complex emergencies
- areas of weaker government and levels of regulation
- areas with limited, developing or poor infrastructure, possibly due to internal conflict or military action
- countries or areas with no (access to) formal banking structure and basic banking safeguards
- where terrorists, proscribed groups and designated individuals/ entities are known to operate or have influence.

For more information on comparative risks in overseas zones, trustees can view the [data on global crime](#) on the World Bank website.

In these situations, even greater effort and stringency will be needed on the part of trustees to ensure risks are assessed and thorough due diligence work undertaken to manage those risks properly.

Other issues to think about include:

- the legal and political environment, including the efficacy of local authorities and government agencies
- cultural issues and local practices
- the nature of civil society, the structure of local delivery organisations and the local, national and international NGO sector operating there
- the nature of activities carried out by local NGOs and partners
- the geographical spread of NGO operations (or partners) and type of work they carry out
- whether the NGO or partner delivers the work itself or delegates it to local agents
- the country's economic structure and environment
- whether the country has an established banking and financial services sector and what safeguards exist in relation to it
- the nature, sources, location and concentration of criminal activity, particularly bribery and corruption
- the main scams, methods and criminal techniques used in this country for laundering money and financing crime
- what payment systems exist, how safe they are and how common cash-based transactions are

The risks will also be influenced by trustees' familiarity with the country they're operating in, their knowledge of local laws, regulations and rules, as well as the broader government and regulatory context. Where a charity is about to begin operation in a country previously unfamiliar to them, especially on a humanitarian assignment, trustees should undertake a comprehensive risk assessment and take particular care and attention.

Charities working internationally must therefore ensure their risk assessments take into account any relevant circumstances arising in the particular country or region of operation. Risks could arise from, for example, any internal conflict or other military action in a country or region, any known terrorist or criminal activity in the area, or working in a remote or sparsely populated area with limited infrastructure.

For more information about how to protect your charity from harm and manage the risk of associations or links with terrorist activity and terrorist organisations, see [Chapter 1](#) of the commission's compliance toolkit, *Protecting charities from harm*. Module 10: The International Dimension explains how different countries may hold their own lists of banned terrorist organisations. The lists hold no direct legal effect in the UK, but may impact on a charity's activities, particularly those conducted internationally.

## 10.3 What do trustees need to do where the risks are high?

### The short answer

Trustees need to ensure that the level of risk is assessed objectively and the safeguards are proportionate. Where the trustees consider that the risks are very high and cannot be adequately managed the appropriate decision may be to stop working in that region, either temporarily or, in extreme cases, permanently.

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### In more detail

In order to fully discharge their duties, trustees must carry out appropriate due diligence on prospective donors, beneficiaries and partners, and also undertake proper monitoring of funds. Failure to do so, particularly where the risks are high, may mean trustees are in breach of their legal duties and this may be regarded by the commission as evidence of misconduct or mismanagement.

As a minimum, it is good practice for trustees of charities operating overseas to check the relevant country's lists of proscribed (banned) organisations and designated individuals/ entities, so that strategic and operational decisions are well informed. This is particularly important when working with a new partner organisation and/or in a high risk region.

In some circumstances, it will be difficult to see how trustees can properly discharge their duties and responsibilities unless they do this. How many international lists the charity consults and how regularly they are monitored needs to be appropriate to the level risk to which the charity is exposed.

You can find a list of proscribed organisations which are banned in the UK on the [Home Office website](#).

There are also other risks to be alert to if a charity receives large donations from overseas (see section 5.4).

If a project is operating in a cash based environment overseas, and funds are not transferred through a formal or reliable banking system, this will present greater risks. It will be even more important in these circumstances to ensure that both manual and computer records are maintained for the use of funds locally connected to the project. A cash ledger, for example, is a basic tool that local and small projects might use to ensure funding use is properly documented.

## 10.4 How do local laws affect the due diligence principles?

### The short answer

Trustees of charities that work internationally need to be aware of and comply with local laws and customs. This is part of sensible due diligence and will help to ensure that charitable projects and aid delivery are not undermined through inadvertent failure to observe both local protocols and national law.

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### In more detail

It is important for trustees of charities that work internationally to be aware of and comply with the local laws that govern a particular area. A charity that operates internationally may operate in areas where the legal framework is very different from that in the UK. For example, developing countries are unlikely to offer citizens the same level of human rights protection as the UK. Charities are likely to be subject to different local laws and varying levels of local regulation in different parts of the world. Charity regulation differs in its scope, nature and effectiveness. It may or may not overlap with the role of the police and law enforcement agencies.

The commission expects trustees to familiarise themselves with the local legal and regulatory framework before carrying out charitable programmes abroad. Being aware of local laws and their application will help to ensure that benefit provided by a charity's activities is not negated by harm that may affect beneficiaries, trustees or charity representatives.

In cases where there is a risk that a charity's activity in another country might breach local laws, the trustees should consider carefully what course of action will be in the best interests of the charity, using both their knowledge of local conditions and the needs of their beneficiaries. Appropriate legal advice should be sought. They will also need to weigh up the likely advantage of undertaking activity against the dangers and disadvantages, including the potential human, financial and reputational cost, of doing so.

## 10.5 Are there specific risks when selecting beneficiaries?

### The short answer

Generally speaking, trustees, should apply the same due diligence principles when selecting beneficiaries overseas, but should adjust processes so that they work effectively in local environments and cultures.

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### In more detail

In some cases charities may work in unstable or volatile situations, for example when delivering humanitarian assistance following natural disasters and during emergencies, in areas where there is armed conflict, or where government infrastructure is weak. Risks will be higher in certain areas or regions than others. Charities, their staff and partners are likely to have a good knowledge and understanding of the local situation, including any local power structures and dynamics, which may affect their work.

There will be particularly high risks for charities when working in areas where proscribed organisations or designated individuals/ entities are known to operate (see the commission's compliance toolkit; **chapter 1, modules 5 and 6**). Trustees must ensure that their charity is not used to commit any criminal offences under counter terrorism legislation.

In the context of those charities whose purposes are the relief of need, trustees must ensure that charitable aid, funds and activities are targeted and delivered to those they intend to assist, on the basis of charitable need. In some situations, such as the delivery of food or other aid to a refugee camp, it may be legitimate for a charity to provide aid to all individuals within a group, even if it happens to include the children or families of terrorists or those responsible for terrorist activity. In doing so, its trustees must be satisfied that:

- the aid, activities or services further the charity's purposes
- the aid, activities or services are, in practice, capable of alleviating the need that has been identified
- the criteria used - by the charity or its partners - when selecting beneficiaries are applied transparently and consistently
- the charity is not breaking charity, counter-terrorism or other applicable law in providing the aid

Trustees must also ensure that they fulfil any obligations under UK or international law regarding the reporting of suspicious terrorist or criminal activity. See the commission's advice on terrorist financing in **S.19 Alert TACT 2000**. Trustees must decide whether an incident is serious enough to report, both to the relevant authority (eg local police if theft) and also to the Charity Commission, via **RSI@charitycommission.gsi.gov.uk**.

Targeting funds or humanitarian aid on the basis of affiliations or connections to a terrorist group, irrespective of whether those in that group are in need, would raise the question of whether the purpose of that support was to indirectly support terrorist activity. It could create an unacceptable association with terrorism and would breach the trustees' duty to ensure charity funds were properly applied.

Humanitarian assistance, charitable aid or funding cannot be denied to people because they support (actively or otherwise) or are sympathetic to the aims of a political body. However, assistance cannot be given solely on the basis of a person's support for a political party or body.

## 10.6 Are there specific considerations that apply for monitoring overseas?

### The short answer

Charities operating internationally will face challenges in delivering services and implementing effective monitoring plans. This can be due to local infrastructure difficulties and associated logistical problems and/ or dependence on partner organisations. Monitoring arrangements might have to be adapted to meet these challenges.

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### In more detail

Although the same general principles of monitoring apply whether the charity operates in the UK or overseas, the way in which they are applied and the extent of oversight required will differ according to the nature of risks faced; in areas/ regions of high risk, trustees should demonstrate a greater degree of monitoring in order to account fully for action taken and funds expended. Many charities are based in the UK and send money to projects, charities, NGOs and direct to beneficiaries in other countries - these charities carry out invaluable work, in challenging circumstances, often helping the neediest in society. Trustees of such charities may need to take additional steps to ensure that charitable funds are properly used and reach intended beneficiaries.

In some cases, the risks will be significantly higher. Sometimes these risks arise because the charity itself is unable to check the funds have been spent properly, requiring trustees to consider carefully what due diligence and monitoring steps they need to undertake. These steps may be more time-intensive than for other (domestic) charities.

### The Finance Act 2010

The Finance Act 2010 states that charities' expenditure overseas could be considered non-charitable and therefore liable for tax if organisations do not take the steps HMRC considers are reasonable to ensure that the funds were used for charitable purposes. Charities must provide evidence that reasonable steps have been taken to establish that donations to offshore recipients would be, and have been spent charitably to the satisfaction of an officer of HMRC. If a charity cannot provide evidence that it took the necessary steps, the expenditure may be deemed non-charitable and tax exemptions would be restricted accordingly.

The Finance Act 2010 also introduces a new condition that those who are responsible for the day-to-day running of a charity are 'fit and proper persons'. For further information on these tax requirements, visit [HMRC's website](#).

## Working with partners internationally

Prospective partners may take a variety of forms, depending on the country they operate in and its particular legal system. Many UK charities work with and decide to select NGOs as partners. NGOs may distribute funds, aid and charitable services to beneficiaries. They can take different forms, including foundations, fundraising committees, law and practice associations, public interest bodies, limited companies and public benevolent institutions. Many NGOs undergo audits or some other form of independent check, and depending on the jurisdiction, this may be a legal requirement. Some adhere to standards upheld by self-regulating or accrediting umbrella bodies.

## Monitoring an overseas project

The most effective monitoring arrangements will use a variety of different methods. Ideally they should be set out by the trustees in any partnership agreement (eg a Memorandum of Understanding) and regularly reviewed. With partnership work, it will also help if any identified gaps in expertise or capacity are offset by contingency planning. Trustees may be able, for instance, to offer overseas partners who are less well-equipped, invaluable guidance on the principles of good governance and management and this objective could form part of the wider overseas mission.

Deciding exactly how to monitor an overseas project will depend very much on individual circumstances and the practical issues involved. Where the risks are higher (eg when operating in a country where financial crime and other crime is known to be a problem) this will need to be reflected, perhaps by increasing the frequency and depth of monitoring checks, particularly around verifying expenditure.

There may be situations in which monitoring activity will potentially expose charity representatives to hazards, or even danger. An example would be where representatives of a charity providing humanitarian aid in a disaster or conflict zone need to make a site visit. In such instances, trustees will need to assess the risks very carefully and ensure that they are reflected in developing a monitoring action plan.

A risk-based approach allows flexibility in deciding what monitoring, reviewing and reporting information is required, how often, and what trustees can do to ensure that they discharge their legal duties. In some cases, risks will only become fully apparent when the operational relationship has commenced. When working with overseas partners, it is important to decide on basic principles before commencing work, eg agreeing segregation of duties.

Difficulties in monitoring and verifying the end use of funds applied overseas may be more acute, but again the same basic principles apply. Monitoring involves making sure that:

- there is a full audit trail for the movement of funds from the charity to its overseas base, which may be operated by a partner organisation
- there are adequate records to demonstrate that the funds have been spent on legitimate aid or other charitable activities
- there is some form of independent evidence to corroborate the paper trail

Effective monitoring should be carried out by competent staff with appropriate skills and expertise. Trustees will need to consider whether they have the necessary skills in-house, or whether a subject specialist should be engaged to carry out aspects of monitoring. In some cases, perhaps where other options are unavailable, trustees may need to use third party or remote verification.

There may be situations where obtaining information is more difficult because of adverse conditions faced by partner organisations within the country of operating, for example, the local infrastructure may have broken down in a disaster zone. Also, in some countries, charities may experience general communication problems, such as limited telephone or internet access. It may be possible in these circumstances to collaborate with other local or international organisations or agents working in the same area by sharing resources.

Working through or with a local partner can be an effective way of delivering significant benefits direct to a local community. It does not, however, alleviate or shift responsibility for ensuring the proper application of the charity's funds by the local partner. That responsibility always remains with trustees, forming part of their duties and responsibilities under charity law. The need to implement risk management strategies therefore remains critical. In some cases, where risks are extremely high, the right decision may be to stop working in that region or country, either temporarily or permanently.

Those charities working in disaster relief, particularly the larger specialist charities, usually have standardised measures in place for due diligence and in many cases well established relationships with local NGOs. In disaster relief situations, the priority is getting aid to those who need it and quickly. Therefore, due diligence and monitoring procedure will, inevitably, have to take a different form in emergency situations and must be flexible enough to allow adaptation. However, the need to deliver humanitarian aid urgently does not justify having no due diligence and monitoring checks in place.

## 11. Technical terms used

**Beneficiary:** a person who is intended to receive benefit from a charity.

**Consolidated list of financial sanctions targets:** the Asset Freezing Unit of HM Treasury is responsible for the implementation and administration of international financial sanctions in effect in the UK, for domestic designations (principally under the Terrorism Order) and licensing exemptions to financial sanctions. A consolidated list of asset freeze targets designated by the United Nations, European Union and United Kingdom under legislation relating to current financial sanctions regimes is available on the HM Treasury website.

**Designated individual or designated entity:** an individual or group who is subject to financial restrictions in the UK, for example because they are suspected of being someone who commits, attempts to commit, participates in or facilitates the commission of acts of terrorism. Individuals or groups can also be subject to country-based sanctions.

**Disclosure and Barring Service:** provides information on criminal records and barring decisions. It helps employers make safer recruitment decisions and prevent unsuitable people from working with adults at risk and children. Its website provides information on how and when to check a person's criminal record. This also provides information on where a charity has a statutory duty to refer an individual to the DBS.

**Due diligence:** is the process and steps that need to be taken by trustees to be reasonably assured of the provenance of the funds given to the charity, confident that they know the people and organisations the charity works with and are able to identify and manage associated risks. What trustees need to apply to undertake due diligence can be described as the 'Know your' principles: know your donor, know your beneficiaries, and know your partner.

**Financial Action Task Force (FATF):** is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. FATF is therefore a 'policy-making body' that works to generate the necessary political will to bring about legislative and regulatory reforms in these areas.

**Governing document:** a legal document setting out a charity's purposes and, usually, its rules of management. Types of governing document include a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal Charter, and scheme of the commission or court.

**HM Revenue & Customs (HMRC):** the government department which collects the vast majority of direct and indirect UK taxes. It is also responsible for overseeing and regulating tax concessions enjoyed by charities, including the Gift Aid scheme.

**Money Service Business/Bureau (MSB):** a business that exchanges currencies, transmits money or cashes cheques for its customers. Money laundering regulations require most MSBs to register with HMRC.

**Non-governmental organisation (NGO):** a not-for-profit organisation which is based on a set of social values, is independent of government and works for the benefit of other people or a class of people. NGOs may or may not also be charities.

**Politically Exposed Person (PEP):** is a term that describes a person who has been entrusted with a prominent public function, or is closely related to such a person. By virtue of this position and the influence it holds, PEPs present a higher risk for potential involvement in bribery and corruption.

**Property:** all assets, including cash, investments, land and buildings.

**Proscribed organisation:** an organisation which the Home Secretary believes to be concerned with terrorism, as defined by the Terrorism Act 2000. It is a criminal offence to be a member of, or invite support for, or arrange a meeting for a proscribed organisation. The financial assets of a proscribed organisation are

regarded as terrorist property and can be subject to freezing and seizure.

Serious incident: A serious incident is an adverse event, whether actual or alleged, which results in or risks significant:

- loss of a charity's money or assets
- damage to a charity's property
- harm to a charity's work, beneficiaries or reputation

If a charity's income is over £25,000, the trustees must, as part of the Annual Return, sign a declaration confirming there were no serious incidents during the previous financial year that should have been reported to the Commission but were not. If incidents did occur, but weren't reported at the time, the trustees should submit these before they file their charity's Annual Return, so they can make the declaration. Until all serious incidents have been reported, the trustees will not be able to make this declaration, or complete the Annual Return, which is a statutory requirement under section 169 of the Charities Act 2011.

National Crime Agency (NCA) [www.nationalcrimeagency.gov.uk](http://www.nationalcrimeagency.gov.uk) The NCA is a new crime-fighting agency with national and international reach, possessing the mandate and powers to work in partnership with other law enforcement organisations to bring the full weight of the law to bear in cutting serious and organised crime. It has five separate commands: border policing; economic crime; organised crime; national cyber-crime; and CEOP (child exploitation and on-line protection).

Suspicious Activity Report (SAR): a disclosure to the National Crime Agency (NCA) under either the Proceeds of Crime Act 2002 or the Terrorism Act 2000.

Trustee: charity trustees are the people who are responsible for the general control and management of a charity. In some charities they may be known as directors, board members, governors or committee members.

## 12. Further information

The links below provide further information for trustees about working internationally:

The Charity Commission's guidance, **Charities: how to manage risks when working internationally**.

**The Code of Conduct for the International Red Cross and Red Crescent Movement and NGOs in Disaster Relief** was developed and agreed upon by eight of the world's largest disaster response agencies. The Code is voluntary and applicable to any NGO. It lays down principles which NGOs should adhere to when undertaking disaster response work.

The Sphere Project was launched in 1997 by a group of humanitarian NGOs and the Red Cross and Red Crescent movement. It consists of a handbook (**Humanitarian Charter and Minimum Standards in Disaster Response**), a broad process of collaboration and an expression of commitment to quality and accountability. The project has developed several tools, in addition to the handbook.

The Human Accountability Partnership (HAP) was founded to promote a better understanding of accountability issues and advocate standards for international NGOs. **HAP's accountability framework** consists of a set of standards and a quality assurance scheme promoted through certification and accreditation.

The **International Committee of Fundraising Organisations** (ICFO) helps to bring together global accreditation procedures and standards, and acts as an international forum for discussion and debate on accreditation issues. ICFO membership covers organisations that monitor fundraising bodies, and individuals or organisations that support the aims of ICFO and wish to take part in meetings and the exchange of information.

The **Active Learning Network for Accountability and Performance in Humanitarian Action** (ALNAP) works to improve the humanitarian performance of those responding to international conflicts and natural disasters through learning and accountability.

**Mango's Guide to Financial Management for NGOs** provides practical advice and tools to everyone working with NGOs, to help them use their funds effectively to meet beneficiaries' needs. It is based on a real understanding of what NGOs do, from Mango's experience of working with NGOs around the world, in the field and in head office.