The Charity Law & Practice Review

CHARITY ACCOUNTING UNDER THE CHARITIES ACT 1993

Robert Vincent[1]

Much heralded, and following two exposure drafts of the Statement of Recommended Practice (SORP), the Regulations made under Part VI of the Charities Act 1993 finally appeared in October 1995 and came into effect on 1st March 1996. For those of us who had been involved in the four year period of gestation, this was a mighty relief. For you, on the other hand, who have probably avoided all contact with the subject up till now, tension may be rising as you contemplate grappling with the subject. The purpose of this article is to 'mark your card' and to lead you through the maze, and hopefully by the end leave you with a clear sense of direction.

The starting point is to gather together the necessary equipment, which is as follows:

- Charity Accounts and Reports: Core Guide - *HMSO*
- Accounting by charities: SORP - *Charity Commission*
- SORP for Smaller Charities - *Charity Commission.*

For those who do not wish to be drawn too deeply into the subject, you can restrict your reading to the Core Guide, a bright red A4 booklet running to 34 pages. This consists of:

- 12 pages of introduction, explanation of the charity accounting framework and summary of the requirements
- 14 pages of the Regulations

---

[1] Robert Vincent, Partner, Buzzacott, 4 Wood Street, London EC2V 7JB
Tel: (0171) 600 0336 Fax: (0171) 606 3408.

The 3rd edition of *Charity Accounting and Taxation* by Robert Vincent published by Butterworths will be available at the end of 1996.

- 7 pages giving the relevant extracts from Part VI of the Act.

The Accounting Framework

At the outset is the simple statement that all charities have to account to the public for the resources they control. It is, however, immediately apparent that not all charities are required to do this in the same way. So the term "charity accounting framework" is used to describe the disciplines that may to a greater or lesser extent apply to your particular charity:

Part VI of the Charities Act 1993, as amended

- The Charities (Accounts and Reports) Regulations 1995
- The Charity Commission regulations on annual returns
- The Charities SORP issued by *The Charity Commission* in October 1995
- Accounting and Financial Reporting Standards issued by the *Accounting Standards Board* (ASB)
- Auditing Standards issued by the *Auditing Practices Board* (APB)
- Charity Commission guidance and directions on the selection and duties of the independent examiner.

To ascertain where your charity fits within the framework, you have to ask the following questions:

(1) Is your charity subject to the jurisdiction of the Charity Commission? Is it exempt from this under Schedule 2 or excepted from the need to file accounts?

(2) If exempt, is the charity governed by the accounting requirements of another Act of Parliament, for example:

- The Industrial and Provident Societies Act 1968?
- The Housing Associations Act 1985?
- The Education Reform Act 1988?

If so it will account and report to the relevant regulatory authority under those Acts. If not, it must abide by the accounting requirements of the

Charities Act 1993, even though it is not obliged to file them with the Charity Commission.

(3) Is it a charitable company to which the accounting and auditing requirements of the Companies Act 1985 apply? If so, only those parts of the charities legislation referring to the annual report and the annual return apply.

(4) Is the charity a "small" charity with annual income below £250,000 a year? If so, certain concessions may apply:

up to £1,000	-	no need to register but should keep accounts and be prepared, if asked, to present them to the Charity Commission. No audit or independent examination.
£1,000 - £10,000	-	required to register and submit annual return. Report and accounts should be prepared but only sent to Charity Commission if requested. No audit or independent examination.
£10,000 - £100,000	-	Accounts may be prepared on Receipts and Payments basis as for smaller charities but they must be either audited or independently examined and submitted to the Charity Commission with an annual report and annual return.
£100,000 - £250,000	-	As for the above category, with the exception that the accounts must be prepared on the 'accruals basis'.
above £250,000	-	The accounts must be professionally audited.

Already one can see that there may be "special" circumstances surrounding the charity's constitution, location, activity or size which may affect its reporting and accounting obligations. It is, however, worth emphasising at this point the overriding influence of the Charities SORP. Although issued by the Charity Commission, it was written by an independent committee and received the approval of the ASB which has established it as "best practice" for **all** charities in the United Kingdom and the Republic of Ireland, except those for which a specific SORP has been written. At the time of writing, I am only aware of three such specific SORPs - Housing Associations, Higher Education and Common Investment Funds.

The Charities SORP

So, despite the number of charities which may fall outside some or all of the accounting requirements of the Charities Act 1993, all of those whose accounts are required to show a true and fair view should adhere to the SORP, which is an integral part of the "charity accounting framework". The basic requirements of this are fully in line with the Regulations and may be summarised as follows:

- Trustees' Report
- Statement of Financial Activities
- Balance Sheet

The Trustees' Report

The trustees' report, or annual report, is required by section 45 of the Act. The form and content are set out in regulation 10 of the Regulations. The main requirements are:

- Legal and administrative details of the charity, its address, objects, organisation, officers and advisers
- Statement of objects, policies, activities, achievements during the year, changes and future developments
- Comments on the financial position in the context of the objects of the charity.

The Statement of Financial Activities

The Statement of Financial Activities takes the place of the Income and Expenditure Account. Instead of concentrating on the "result" - a surplus or deficit - it shows all the incoming resources of the charity, including capital receipts, and all outgoing resources. The "bottom line" is the net increase or decrease in resources available to the charity. The important points are to report the main sources of finance and the main areas of expenditure - "what have you done with the money?"

Another aspect of the Statement of Financial Activities is that it divides the report into columns, showing separately those funds which are restricted from those which are unrestricted. This is of great help and importance as it shows clearly the resultant funds available in each category at the end of the year to meet the demands of each. Very often charities find themselves in the awkward position of apparently having plenty of income, but realising that much of it is held for a restricted purpose, leaving insufficient available for the general purposes of the charity.

The columnar format of the Statement of Financial Activities will help trustees to draw attention to such difficulties for example:

	Restricted Funds	Unrestricted Funds	Total
Incoming Resources			
Voluntary Income	600	700	1,300
Investment Income	70	20	90
	670	720	1,390
Outgoing Resources			
Direct charitable expenditure			
• Children's residential homes	50	680	730
• Childcare advisory service	300	-	300
Other Expenditure			
• Fundraising	50	50	100
• Management & Administration	40	80	120
	440	810	1,250
Net movement in resources	230	(90)	140

This shows that although there has been an overall increase in the charity's resources during the year of 140, the unrestricted or general funds decreased by 90.

The Balance Sheet

The Balance Sheet is conventional, showing the fixed capital assets separately from the current assets less current liabilities. The only new requirements of importance are the inclusion of investments, including investment property, as fixed assets at **market value**. Lesser matters include the capitalisation of fixed assets and the distinction between liabilities and designated funds, i.e., amounts set aside for a particular purpose but which the trustees could redirect if they wished. This last point is likely to continue to cause problems for charities, not so much because of the accounting aspect, as for the possible disagreement between trustees concerning the level of their commitment in respect of promises of support to the beneficiaries of the charity. Are they obliged to make the grant or can they change their mind?

The Regulations

The Charities (Accounts and Reports) Regulations 1995 define the content of the Trustees' Report in regulation 10 and the content of the accounts in regulations 3 and 4 and Schedule 1. The overriding requirement given in paragraph 1 of Part III of Schedule 1 is that the accounts should give a true and fair view. In the rare cases where trustees feel it necessary to depart from the prescribed format or content of accounts, they must, if it is material, disclose the fact and give their reasons for so doing.

Regulations 6 and 7 set out the duties of the auditor and independent examiner respectively. Charities with incomes in excess of £250,000 a year must have their accounts professionally audited. Those with incomes between £10,000 and £250,000 may appoint an independent examiner. In the former case, the auditor must state whether the accounts comply with regulation 3 and give a true and fair view of the state of affairs at the balance sheet date and of the incoming and outgoing resources during the year. He also has an obligation to report certain deficiencies if applicable, e.g., if the accounting records have not been kept in accordance with the requirements of section 41 of the 1993 Act, or if any of the information given in the trustees' report is incompatible with that in the accounts. In the case of an independent examiner, he should report that his examination has been carried out in accordance with the directions of the Charity Commissioners and state whether or not any matter has come to his attention giving him reasonable cause to believe that accounting records have not been kept in accordance with section 41 or the accounts do not accord with the records or they do not comply with the requirements of Regulation 3 or 4. He should further state whether or not any matter has come to his attention to which attention should be drawn to enable a proper understanding of the accounts to be reached.

In deciding whether to appoint an auditor or an independent examiner, trustees will need to consider the degree of scrutiny and level of opinion that is appropriate to their organisation. Cost may be one factor; reassurance may be another.

Conclusion

This article has only skimmed the surface of the Charities SORP and the Regulations made under the Charities Act 1993 but with luck it may have helped you to see where your charity stands in the "accounting framework". This should enable you to establish, first of all, under which statute or statutes your charity is obliged to account and, secondly, the form and content of the accounts and level of accountability required. Most charities in England and Wales will fall under either The Charities Act 1993 or The Companies Act 1985. In both cases the Charities SORP applies and should be followed. We are promised that in due time the Companies Act 1985 will be amended to bring the accounting and auditing requirements of charitable companies in line with those for unincorporated charities. That will certainly help simplify matters, but perhaps charities have had their share of parliamentary time for the moment.