

ACCOUNTING  
& REPORTING

# Independent Examination of Charity Accounts Trustees' Guide

April 2009



## The Charity Commission

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

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

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

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# Independent Examination of Charity Accounts: Trustees' Guide

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# A

## Introduction

### A1. What is this guidance about?

This guidance has been written for trustees and explains what is involved in an independent examination of a charity's accounts and when a charity can opt for an independent examination in place of an audit. Guidance is also provided about who can undertake an independent examination and the matters that trustees need to consider when selecting and appointing an independent examiner. The respective responsibilities of trustees and examiners are also explained and some recommendations are made that can help ensure the examination is efficiently and effectively undertaken.

### A2. 'Must' and 'should': what we mean

In this guidance, where we use '**must**', we mean it is a specific legal or regulatory requirement affecting the trustees of a charity. Trustees must comply with these requirements. To help you easily identify those sections which contain a legal or regulatory requirement we have used the **L** symbol next to the short answer in that section.

We use '**should**' for items we regard as minimum good practice, but for which there is no specific legal requirement. Trustees should follow the good practice guidance unless there is a good reason to depart from it.

We also offer less formal advice and recommendations which trustees may find helpful in organising and planning the examination of their charity's accounts.

This guidance is a new addition to our series of publications. Previously, trustees who wished to gain an understanding of independent examination had to refer to *Independent Examination of Charity Accounts: Directions and Guidance Notes* (CC63) which was primarily aimed at independent examiners rather than the trustees who appoint them.

### A3. Scope of this guidance

This guidance provides a general introduction and overview of what is involved in an independent examination. The guidance is written for trustees who are responsible for deciding whether to have an independent examination instead of an audit and for selecting and appointing their independent examiner.

This guidance also addresses important changes in the scrutiny (independent examination and audit) arrangements introduced by the Charities Act 2006 (the 2006 Act) and the Charities (Accounts and Reports) Regulations 2008 (the 2008 Regulations) which apply to the examination of accounts of non-company charities and eligible small charitable companies incorporated under company law for accounting periods beginning on or after 1 April 2008. This guidance also addresses the revised thresholds for independent examination introduced by The Charities Acts 1992 and 1993 (Substitution of Sums) Order 2009 (the 2009 Order) applying to financial years ending on or after 1 April 2009.

When the Charities Act 2006 was passed an undertaking was made to Parliament that the implementation of the Act would be reviewed within five years. It is therefore anticipated that the financial thresholds will be considered again as part of this review.

This guidance is written for trustees of all types of charities eligible for independent examination, whether they are companies, trusts or associations.

### A4. Using this guidance

The key to a successful independent examination is an understanding of the respective responsibilities of the trustees and the examiner in relation to the preparation, scrutiny and filing of accounts. A successful examination will be dependent on

understanding what an examination involves, who may undertake it and selecting an examiner with the skills and experience to undertake a competent examination.

Reading section B (which gives an 'at a glance' summary) will provide trustees with a general understanding of the requirements for independent examination. Section C of this guidance explains what trustees need to know about independent examination and section D sets out what trustees need to consider when selecting and appointing an independent examiner. Finally, section E of this guidance contains some recommendations to help make the examination process efficient and effective.

Trustees, and in particular the Honorary Treasurer, need to know what an independent examination involves before they opt to have an examination in place of an audit. By understanding what is involved, trustees can have their accounting records, Annual Report, accounts and explanations ready to assist the examiner to complete their work in a timely way.

## A5. Terms and definitions

The following terms are used throughout this document, and should be interpreted as having the specific meanings given.

**(The) 1993 Act:** The Charities Act 1993 as amended by the Charities Act 2006.

**(The) 2006 Act:** The Charities Act 2006.

**(The) 2008 Regulations:** The Charities (Accounts and Reports) Regulations 2008 (SI 2008 No.629).

**(The) 2009 Order:** The Charities Acts 1992 and 1993 (Substitution of Sums) Order 2009 (SI 2009 No. 508).

**Accounting standards:** Accounts which are intended to show a true and fair view (the accruals basis) should conform to certain standards issued or adopted by the Accounting Standards Board. These standards, with which

professional accountants are expected to be familiar, comprise a number of 'Statements of Standard Accounting Practice' (SSAP), 'Financial Reporting Standards' (FRS) and 'Urgent Issues Taskforce Abstracts' (UITF abstracts) and SORPs.

**Accruals basis:** This concept requires the effects of transactions and other events to be reflected, as far as possible, in the accounts for the period in which they occur, and not, for example, in the period in which any cash settlement is made. This concept is central to the recognition of balance sheet assets and liabilities.

This term has been used to describe accounts prepared in accordance with the requirements of section 42(1) of the 1993 Act. Such accounts should be prepared by the trustees to show a 'true and fair view'. The accounts comprise:

- a statement of financial activities;
- a balance sheet; and
- notes to the accounts.

Such accounts should be prepared on a basis of accounting policies that enable the accounts to give a true and fair view and are consistent with accounting standards and the accounting concepts of going concern and accruals.

**(The) Directions:** The Directions to independent examiners are made by the Commission under a power granted under section 43(7)(b) of the 1993 Act. The Directions which apply to the independent examiner only set out what procedures must be followed when undertaking an examination.

**Directors:** Directors are one or more persons over the age of 18 who are responsible in law for the operations of the company. The directors form a 'Board of Directors' which constitutes the decision making body and the Board is responsible for managing the company's affairs. Directors have specific duties under company law and are legally liable for their actions. The trustees of a charitable company are its directors.

**Endowment:** Endowment funds are a form of restricted fund where trustees are legally required to invest or retain the capital. Income generated from the capital can be spent. Normally these funds will represent investments but may also represent property held as endowment for use by the charity. There are two forms of endowment. Permanent endowment is a fund where the trustees do not have the power to spend the capital. Expendable endowment is a fund where the trustees have the option to spend the capital, under certain circumstances, in the same way as spending income funds.

**Evidence:** The information or facts gathered by the examiner during the course of the examination. The sources of evidence available include the accounts, the accounting records, the examiner's analytical review, the explanations given in answer to questions, matters established through any verification procedures that prove necessary and the charity's other records, for example minutes of trustee meetings.

**Financial year:** The period for which statutory accounts are prepared.

**Form and content:** The statutory requirements as to disclosures, analysis and information which must be contained in accruals accounts.

**Governing document:** A document setting out the charity's purposes and, usually, how it is to be administered. It may be a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal Charter, Scheme of the Commission, or other formal document. The trusts of a charity are the provisions contained in the governing document(s) of the charity.

**Group accounts:** Accounts that consolidate or combine the accounts of a charity and any subsidiaries, for example a trading company, its controls. The purpose of group accounts is to provide information about the group and its financial activities as a whole.

**Gross income:** Section 97 of the 1993 Act defines gross income to mean the gross recorded income from all sources including special trusts. For accounts prepared on a receipts and payments basis gross income is simply the total receipts recorded in the statement from all sources excluding the receipt of any endowment. For accounts prepared on an accruals basis gross income is the total incoming resources as shown in the Statement of Financial Activities (prepared in accordance with the SORP) for all funds including any amount transferred to income funds during the year from endowment funds in order to be available for spending, but excluding the receipt of any endowment. For further information, refer to the glossary and supporting information relating to your charity's Annual Return.

**Gross (Total) assets:** The aggregate amount of assets of a charity, before the deduction of liabilities, as at the balance sheet date, ie at the close of the last day of the charity's financial year.

**Letter of engagement:** A letter addressed to the charity trustees from the independent examiner detailing the accounting responsibilities of the charity trustees and the statutory responsibilities of the independent examiner. It may also include matters such as fee arrangements, proposed timetable for the examination and details of any non-statutory work to be undertaken by the examiner. The purpose of the letter is to reduce misunderstanding and the content of any such letter should be agreed in writing with the charity trustees.

**Non-statutory accounts:** Non-statutory accounts are accounts prepared by the trustees which are not prepared under or required by Part 6 of the Charities Act 1993 and the applicable 2008 Regulations, or where the charity is a company, Part 15 of the Companies Act 2006. Such accounts include management accounts prepared during the year to inform trustees about the finances of the charity, and group accounts which are prepared on a voluntary basis.

**Professional audit:** An audit undertaken by a person who is eligible under the 1993 Act, normally a registered auditor. The auditor has to express a professional opinion as to whether the accounts are 'true and fair' and they conduct the audit in accordance with relevant auditing standards.

**Receipts and payments basis:** Accounts prepared under section 42(3) of the 1993 Act. The accounts comprise:

- a receipts and payments account; and
- a statement of assets and liabilities.

Such accounts do not purport to show a 'true and fair view'; instead they should provide a factual summary of money received and paid during the year and a statement providing information as to the charity's assets and liabilities at the end of the year.

**Restricted income funds:** Funds that the trustees are able only to spend on particular purposes of the charity. Restricted income funds are subject to specific trusts which may be declared by the donor(s) or with their authority (eg in a public appeal) or created through a legal process, but are still within the wider objects of the charity.

**SORP:** The Statement of Recommended Practice – Accounting and Reporting by Charities, issued in March 2005, sets out the recommended practice for the purpose of preparing the Trustees' Annual Report and for preparing accounts of a charity on an accruals basis. The accounting recommendations of the SORP do not apply to charities preparing receipts and payments accounts.

**Statutory accounts:** Statutory accounts are the accounts prepared by the trustees which are required by and meet the form and content requirements of Part 6 of the Charities Act 1993 and the applicable 2008 Regulations, or where the charity is a company, Part 15 of the Companies Act 2006, to which are appended the required Trustees' Annual Report and, where required by law or the charity's governing document, the external scrutiny report prepared by the auditor or independent examiner.

**Statutory audit:** Where the term statutory audit is used this refers to the requirement in charity law for an audit to be carried out where the charity's gross income and/ or assets exceed the relevant threshold by a person who is eligible for appointment as auditor of a company, or a person approved by the Commission in accordance with the 2008 Regulations.

**Trusts:** These are the provisions which at any given time regulate the purposes and administration of the charity.

**Trustees (charity trustees):** Charity trustees are defined by section 97 of the 1993 Act and are the people who, under the charity's governing document, are responsible for the general control and management of the administration of the charity. In the charity's governing document they may be called trustees, managing trustees, committee members, governors, or directors, or they may be referred to by some other title.

**Unrestricted funds:** Funds which the trustees are able to spend at their discretion for any of the charity's purposes. Unrestricted funds may also contain part of the unrestricted funds which the trustees have earmarked for a particular purpose; these earmarked funds are called designated funds. Such designated funds are legally part of the unrestricted funds, though they may be reported separately in the balance sheet or notes, where accruals accounts are prepared, or as part of unrestricted funds, where receipts and payments accounts are prepared.

# B

## Independent examination at a glance

To maintain public confidence in the work of charities, charity law requires most charities to have an external scrutiny of their accounts. Provided a charity is not required by law or its governing document to have an audit then trustees may choose a simpler and less expensive form of external scrutiny called an independent examination.

For financial years beginning on or after 1 April 2008 and ended on or before 31 March 2009, trustees may opt for an independent examination provided their charity's gross income is not more than £500,000, or where gross income exceeds £100,000 its gross assets are not more than £2.8 million.

For financial years ending on or after 1 April 2009, the gross income threshold of £500,000 remains unchanged but the gross asset threshold is increased to £3.26 million where gross income exceeds £250,000.

An independent examination is a simpler form of scrutiny than an audit but it still provides trustees, funders, beneficiaries, stakeholders and the public with an assurance that the accounts of the charity have been reviewed by an independent person. For financial years starting on or after 1 April 2008, independent examination is also an option for eligible small charitable companies which are not required to have an audit. Charitable companies that opt not to have an audit will have to have an examination where their gross income exceeds £10,000 for an accounting year ending on or before 31 March 2009. The threshold at which an independent examination is required increases to a gross income exceeding £25,000 for financial years ending on or after 1 April 2009.

Whether acting as a volunteer or being paid a fee for their work, the role of the independent examiner is important and they must follow certain steps in carrying out the examination and make a report to the trustees setting out particular matters once they have finished their examination. There is a process to be followed and separate guidance - *Independent Examination of Charity Accounts: Examiners' Guide* (CC32) - is available which takes the examiner through the Directions which set the procedures that the examiner must follow, explains their reporting duties and provides the examiner with practical advice at every stage.

Whilst in most cases the examiner will be reviewing receipts and payments accounts and so will not need to be a qualified accountant to carry out a proper independent examination, the examiner still needs a certain level of ability and knowledge to undertake a competent examination and to set out their report in the way that is required by the 2008 Regulations. Where gross income is more than £250,000 charity law requires the examiner to be a member of a body listed in the 1993 Act.

Where accruals accounts are prepared the examiner needs to have an up-to-date understanding of accruals accounting and to be familiar with the '*Statement of Recommended Practice: Accounting and Reporting by Charities (2005)*', otherwise known as the SORP. The law requires that the examiner has the requisite ability and experience to carry out a competent examination and greater accountancy skills and knowledge will be needed if the charity is preparing accruals accounts.



# What do trustees need to know about independent examination?

This section sets out the key information that trustees need to know when deciding whether or not to opt for an independent examination of their charity's accounts.

## C1. What is an independent examination?



### The short answer

An independent examination is an external review of a charity's accounts and is carried out by an independent person with the requisite ability and practical experience to carry out a competent examination.

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### In more detail

Independent examination was introduced by Part 6 of the 1993 Act and section 43 of the 1993 Act allows trustees of smaller charities to opt for this simpler form of external scrutiny in place of an audit.

An independent examination provides an external check on the accounts and can be carried out by any person with the relevant ability and experience, except where the gross income exceeds £250,000, when only members of one of the bodies listed in the 1993 Act (see section D1) can undertake the examination. An examination is a less onerous form of scrutiny than an audit and provides less assurance in terms of the depth of work which is to be carried out. What the examiner must do is set out in the Directions made by the Commission (see CC32) and the content of the examiner's report is set out in the 2008 Regulations.

An examiner, in their report, is only required to confirm that no evidence has been found that suggests certain things have not been done by the charity. This form of 'negative assurance' is a more limited form of scrutiny. The examiner is not acting as an auditor and so is not required to plan their work, to identify fraud or to test the internal financial controls operating in the charity.

An examination involves a review of the accounting records kept by the charity and a comparison of the accounts presented with those records. It also involves a review of the

accounts and the consideration of any unusual items or disclosures identified. It is important to note that verification and vouching procedures, where an item in the accounts is checked against an original document such as an invoice or a receipt, only becomes necessary where significant concerns are identified from the work of the examiner, or where satisfactory explanations cannot be obtained from the trustees.

In the examiner's report, the examiner is only required to provide a statement on specific matters that have come to their attention as a result of the examination procedures specified in the Directions made by the Commission. This is a simpler requirement than that of an audit. An auditor is required to build up a body of evidence to support a positive statement of opinion on the accounts. In particular, an auditor is required to form an opinion as to whether the accounts show a 'true and fair view'.

Where a significant concern relating to the accounts that the examiner considers important to the understanding of the accounts remains unresolved or other matters arise that must be included in the examiner's report come to the examiner's attention, then consideration will be needed as to how this is reported. If a matter is identified which is of material significance to the Commission, where we are likely to consider using our inquiry powers, the examiner also has to make a separate report on that matter to the Commission in addition to the examiner's report attached to the accounts.

## C2. Which charities can opt for an independent examination?



### The short answer

For financial years ending on or before 31 March 2009, charities with gross income in the year of £10,000 or less are not required to have any form of external scrutiny. For financial years ending on or after 1 April 2009, this threshold is increased so that charities with gross income of £25,000 or less are not required to have an external scrutiny.

For financial years ending on or before 31 March 2009, charities with a gross income of £500,000 or less may choose to have an independent examination in place of an

audit unless both their gross assets exceed £2.8 million and their gross income exceeds £100,000.

For financial years ending on or after 1 April 2009, the gross asset threshold and the gross income level at which the asset threshold applies is increased so that charities with a gross income of £500,000 or less may choose to have an independent examination in place of an audit unless both their gross assets exceed £3.26 million and their gross income exceeds £250,000.

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### In more detail

The thresholds for independent examination increased for financial years ending on or after 1 April 2009. The thresholds that now apply are set out below. Gross income should be calculated in accordance with the Commission's guidance, as set out in Appendix 1.

For charities with financial years starting on or after 1 April 2008 and ending on or before 31 March 2009, the thresholds for statutory audit are:

- gross income of more than £500,000; or
- gross assets of more than £2.8m million where gross income is more than £100,000 in the financial year.

Unless gross income exceeds £100,000 then the gross asset threshold of £2.8 million does not apply.

For charities with accounting periods ending on or after 1 April 2009, the thresholds for statutory audit are increased to:

- gross income of more than £500,000; or
- gross assets of more than £3.26m million where gross income is more than £250,000 in the financial year.

Unless gross income exceeds £250,000 then the gross asset threshold of £3.26 million does not apply.

The flow chart in Appendix 2 sets out the steps for determining whether an individual charity is eligible for independent examination.

The option of independent examination also applies to small charitable companies for accounting periods commencing on or after 1 April 2008 which are not required to have a statutory audit. Although charitable companies which are eligible for audit exemption under company law may opt for an independent examination in place of a charity audit on the same basis as non-company charities, their duty to maintain accounting records, and the form and contents of their accounts still remain subject to company law.

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Charities below these thresholds for audit may normally opt for an independent examination unless the charity's governing document requires otherwise. For financial years ending on or before 31 March 2009, there is normally no requirement for any independent scrutiny where the gross income for the year in question is £10,000 or less. For financial years ending on or after 1 April 2009, this threshold is increased and normally no requirement for any independent scrutiny arises where the gross income for the year in question is £25,000 or less.

Where the gross income of the charity exceeds £250,000 in a financial year and the charity is not subject to statutory audit, the 2006 Act introduced a new requirement for the examiner to be a member of a listed body. These bodies are listed in the 1993 Act and are also set out in section D1 of this guidance.

### C3. What is the legal framework for an independent examination?



#### The short answer

The external scrutiny requirements applying to charities are set out in Part 6 of the 1993 Act. The matters that must be included in an independent examiner's report are set out in the 2008 Regulations.

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#### In more detail

The 1993 Act made provisions for regulations governing the form and content of charity accounts, Trustees' Annual Reports and the duties of charity auditors and independent examiners. These requirements are set out in the 2008 Regulations and apply to accounting periods commencing on or after 1 April 2008. The 1993 Act provides for some form of independent scrutiny for the accounts of all but the smallest charities, but this will fall short of a full requirement for an audit for the majority of charities. The 2008 Regulations set out what must be included in an independent examiner's report.

In particular, the examiner must then state in their report whether or not any matter has come to their attention, in connection with the examination, which gives them reasonable cause to believe that in any material respect:

- accounting records have not been kept as required by law;
- the accounts do not agree with those accounting records;
- the accounts do not meet accounting requirements of the 2008 Regulations (or in the case of a charitable company with company law and prepared in accordance with the methods and principles of the SORP);

In addition, the examiner must provide a statement within their report if the following specific matters have become apparent during the course of the examination:

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any material expenditure or action which appears not to be in accordance with the trusts of the charity;

- any failure to be provided with information and explanation by any past or present trustee, officer or employee that is considered necessary for the examination; and
- in the case of accruals accounts any material inconsistency between the accounts and the Trustees' Annual Report and, in the case of a charitable company, with the director's report.

The 2006 Act also introduced a new legal duty for independent examiners to make a written report to the Commission where, during the course of their examination, they become aware of a matter which relates to the activities or affairs of the charity, or of any connected institution or body, and they have reasonable cause to believe that the matter is likely to be material to the Commission in the exercise of its inquiry functions. This duty to report matters of significant concern to the Commission is more fully explained in our publication *Independent Examination of Charity Accounts: Examiners' Guide* (CC32) which is written specifically to assist examiners in their work.

Independent examiners also have a discretion to report if they so wish any matters they believe are 'relevant' to the exercise of any of the Commission's functions.

This legal framework applies to all charities registered with the Commission and those charities currently excepted from registration.

## C4. Where can I find the Regulations?

### The short answer

Whilst trustees are unlikely to need to refer to the detail of 2008 Regulations when considering the option of independent examination, the Regulations are available from the Office of Public Sector Information's website.

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### In more detail

The 1993 Act, the 2006 Act and the 2008 Regulations apply to England and Wales only. Copies of the 1993 Act and 2006 Act are available from the Office of Public Sector Information's website. The 2008 Regulations are also available on-line at [www.opsi.gov.uk/si/si2008/uksi\\_20080629\\_en\\_1](http://www.opsi.gov.uk/si/si2008/uksi_20080629_en_1)

## C5. For what other reasons might an audit be needed?

### The short answer

Having checked whether the charity's gross income and gross assets are below the charity audit threshold, there are a number of additional points for the trustees to consider before the examiner is appointed and starts work. An audit may still be needed even though the charity is below the audit threshold.

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### In more detail

An audit may be needed for other reasons including a requirement:

- under the charity's governing document for an audit (although the trustees may be able to amend the governing document) – see Appendix 2;
- under another statutory or regulatory regime, such as those relating to registered social landlords and NHS charities; or
- a requirement placed on the charity by a funder or lender.

Trustees may also choose an audit if they prefer the higher level of assurance that it provides. Due to the extra work an audit involves and due to developments in International Standards on Auditing, trustees need to be aware that an audit is likely to be considerably more expensive than an independent examination.

Charities that are incorporated under company law will have a memorandum and articles of association and the articles may include an audit requirement. If the charity is a company then the examiner will need to be familiar with the additional accounting and reporting requirements that apply to small companies. The trustees of charitable companies are responsible for ensuring that the content of the director's report, which can incorporate the Trustees' Annual Report, complies with the requirements of the Companies Act 2006.

# D

## How to select your examiner

Section 43(7)(a) of the 1993 Act allows the Commission to issue guidance to charity trustees regarding the appointment of an independent examiner. Trustees should read the following section to ensure that they have taken all the steps they need to take in order to properly select and appoint their examiner.

### D1. Who can carry out an independent examination?

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#### The short answer

The charity trustees should take steps to ensure that a competent examination takes place and they will therefore consider carefully the suitability and eligibility of a prospective independent examiner.

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#### In more detail

An independent examiner as described in section 43(3)(a) of the 1993 Act is “an **independent person** who is reasonably believed by the charity trustees to have the **requisite ability** and **practical experience** to carry out a **competent examination** of the accounts”. Once a charity’s gross income exceeds £250,000, the examiner must be a person who is a member of one of the following bodies listed in the 1993 Act and should be allowed by the rules of that body to undertake the role of independent examiner:

- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- Institute of Chartered Accountants in Ireland
- Association of Chartered Certified Accountants
- Association of Authorised Public Accountants

- Association of Accounting Technicians
- Association of International Accountants
- Chartered Institute of Management Accountants
- Institute of Chartered Secretaries and Administrators
- Chartered Institute of Public Finance and Accountancy
- Fellow of the Association of Charity Independent Examiners

Charity trustees are entitled to pay reasonable remuneration to an independent examiner for their services and if they are unable to obtain the services of a competent examiner on a voluntary basis, should be prepared to pay such remuneration and regard it as a proper cost of administering the charity.

## D2. What is an independent person?

### The short answer

Independence means that the examiner is not influenced, or perceived to be influenced, by either close personal relationships with the trustees or by day-to-day involvement in the administration of the charity.

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### In more detail

For an examiner to be independent that individual should have no connection with the charity trustees which might inhibit the impartial conduct of the examination. An examiner cannot independently review his or her own work and so the person who is the charity's book-keeper cannot be the charity's examiner. However this does not mean an examiner cannot be a member or supporter of the charity and often some involvement brings an added quality of personal enthusiasm and familiarity to the role of examiner.

Where a potential independent examiner is a member of the charity, for example a member of a church congregation, provided they have not been involved in the day-to-day decision making or administration of the charity, for example by serving on a committee or sub-committee convened by the charity, and are not connected with the charity trustees, then normally they may act as an examiner, subject to their having the necessary ability, experience and qualification required. Also the right to take

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part or attendance as a member in an annual general meeting would not preclude the examiner from conducting an independent examination although active participation in the administration of the charity, for example through tabling resolutions would.

Whether a connection with the charity affects independence will depend upon the particular circumstances but the following persons will not normally be considered to be independent:

- a. the charity trustees or anyone else who is closely involved in the administration of the charity;
- b. a major donor to or major beneficiary of the charity; or
- c. a child, parent, grandchild, grandparent, brother or sister, spouse, civil partner, business partner or employee of any person who falls within sub-paragraph (a) or (b) above.

### D3. What skills does the examiner need?



#### The short answer

The appointment of an independent examiner is made by the trustees who must reasonably believe that the person selected has the requisite ability and practical experience to carry out a competent examination of the accounts.

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#### In more detail

In the House of Lords' debate on the Charities Bill which led to the 1993 Act, it was stated that "an independent examiner must obviously be competent for the task that he is to do and he must be familiar with accounting methods, but he need not be a practising accountant. We have in mind ... people such as bank or building society managers, local authority treasurers or retired accountants. They would all be suitable as independent examiners".

The quality of the evidence of ability which is required will depend upon whether the accounts are prepared on a receipts and payments basis or an accruals basis, and the size and nature of the charity's transactions.

It is recommended that trustees of charities preparing their accounts on an accruals basis should consider selecting a person who is a member of one of the bodies listed in the 1993 Act (see section D1), or similarly skilled person, who demonstrates a good understanding of accountancy principles, accounting standards and knowledge of the SORP.

The majority of charities have a gross income below the threshold at which accruals accounts must be prepared and, unless constituted as a company under company law, are able to prepare simple receipts and payments accounts. This form of accounting is very straightforward and provides a simple alternative to accruals accounts that fully meets the legal requirements of smaller charities. Knowledge of accounting standards and the SORP is not required to examine receipts and payments accounts.

For financial years ending on or before 31 March 2009, non-company charities can prepare receipts and payments accounts if their gross income is £100,000 or less. For financial years

ending on or after 1 April 2009, this threshold is increased so that non-company charities may prepare receipts and payments accounts provided their gross income, for the relevant year, is £250,000 or less.

While previous experience will be very helpful, where receipts and payments accounts are prepared, any person with financial awareness and numeracy skills should be competent to act as an independent examiner provided they have read and understood our publication *Independent Examination of Charity Accounts: Examiners' Guide* (CC32) and apply it when reviewing a set of receipts and payments accounts.

Whether receipts and payments accounts or accruals accounts are prepared, the examiner needs some familiarity with certain basic principles including the different types of income funds (unrestricted and restricted) and capital funds (permanent and expendable endowment), the nature of trusts, the responsibilities of trustees, and the role of the charity's governing document. For more information about the duties of trustees refer to our publication *The Essential Trustee: What you need to know* (CC3).

Charity trustees should also satisfy themselves that prospective examiners have practical experience relevant to the charity in question which might include that person having:

- an involvement in the financial administration of a charity of a similar nature; or
- acted successfully as an independent examiner on previous occasions for such charities; or
- relevant practical experience in accountancy or commerce.

## D4. Can our group accounts be independently examined?



### The short answer

Where group accounts, consolidating the accounts of a charity and any subsidiaries, are prepared because they are required by law then they must be audited.

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### In more detail

Some charities have a trading subsidiary which is often registered as a company under company law and carries out commercial trading in order that any profits made can be Gift Aided to the charity. Unless the aggregate gross income of the group, that is the gross income of the charity together with that of any subsidiaries (after eliminating intra group transactions), exceed the statutory threshold of £500,000 there is no requirement to prepare group accounts. Where the aggregate gross income exceeds £500,000 the group accounts must be prepared and audited.

If group accounts are prepared below this threshold then they would be voluntary accounts and any examination of those accounts would be on a non-statutory basis although the principles set out in the Directions made by the Commission could be applied by a contractual arrangement between the charity and the examiner. If the trustees wish to submit group accounts prepared on a voluntary basis as their statutory accounts, then the group accounts

should comply with the requirements of the 1993 Act, the 2008 Regulations and the SORP. If the parent charity is a company, it is recommended that the group accounts also comply with company law, particularly if the accounts are to be used for filing purposes at Companies House.

A parent charity's own accounts, if they exceed the threshold for independent examination or audit, must be examined or audited in line with threshold requirements when they are included in group accounts to be filed with the Commission. This requirement applies even if the group accounts are prepared on a voluntary basis for filing with us.

For more information on group accounts please refer to the relevant section of the SORP and for details of the preparation threshold to our CC15 series of publications - *Charity Reporting and Accounting: The Essentials* - for the relevant financial year.

## D5. What other steps should charity trustees take when selecting and appointing independent examiner?



### The short answer

To summarise, the trustees need to take reasonable steps to ensure a competent examination. This involves consideration of a prospective examiner's independence, abilities and experience.

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### In more detail

Before appointing an examiner, we recommend that the trustees should ask the prospective examiner to confirm that:

- they are satisfied as to their independence from the charity and its trustees;
- where accruals accounts are prepared that they believe they have the necessary ability and experience to undertake their work including knowledge of the SORP;
- they have met any requirements (for example, a practising certificate) of their own professional body to act as an examiner; and
- where appropriate they hold professional indemnity insurance.

Where appropriate, the trustees may ask an examiner to give details of their experience, accreditation, or qualifications and this is particularly relevant where the examiner has to be a member of a body listed in the 1993 Act (see section D1) or accounts prepared on an accruals basis are being examined.

By obtaining this assurance, whether by e-mail, letter, or where a fee is charged in the engagement letter, the trustees can

demonstrate they have paid proper regard to the requirement to select an examiner with "requisite ability and practical experience". Where the examiner is charging a fee the trustees should be notified by a letter of engagement setting out the basis on which the examiner has agreed to act. These terms of engagement should recognise, and not limit, the examiner's statutory duties.

Whilst not all examiners have to hold a professional accountancy qualification, the trustees must always appoint a person suitable for the circumstances of the charity and the trustees should ensure that the Commission's guidance concerning the skills (see D3) required of the examiner for accruals accounts has been followed.

Charity trustees should discuss fully with the prospective examiner the work of the charity and their expectations. They should ensure that the prospective independent examiner has a copy of *Independent Examination of Charity Accounts: Examiners' Guide* (CC32) and is familiar with the Charity Commission's Directions to independent examiners and understands the duty to provide an independent examiner's

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report. Where accruals accounts are prepared under section 42(1) of the Act 1993, the examiner should also be conversant with the 2008 Regulations as to the form and content of those accounts and the SORP.

Where the charity is a small company, the examiner should also be aware of the accounting requirement of the Companies Act 2006 as to the form and content of those accounts in addition to having familiarity with the SORP.

Charity trustees who follow these guidelines and gain suitable assurances from prospective examiners, and from any references, can be satisfied that they have taken all reasonable steps to appoint an examiner with the ability and experience to undertake a competent independent examination of their accounts.

A **competent examination** is one that is conducted with reasonable skill and care in accordance with the Directions for independent examination.

# E

## How to prepare for an independent examination

To ensure an efficient and effective examination some preparation is necessary. Charity trustees need to understand their duties in relation to maintaining accounting records, preparing accounts and filing them. Trustees should ensure all accounting records are up to date and readily available and ensure that draft accounts and Annual Report have been prepared (unless it has been agreed that the examiner will draft the accounts from the accounting records) in time for the examination as an important first step.

### E1. What accounting records should be available to the examiner?



#### The short answer

All charities must keep accounting records and these must be up to date and made available to the independent examiner.

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#### In more detail

All charities must keep accounting records. These records (eg cash books, invoices, receipts, Gift Aid records etc) must be retained for at least 6 years (or at least 3 years in the case of charitable companies). Where Gift Aid payments are received records will need to be maintained for 6 years with details of any substantial donors maintained in accordance with HMRC guidance.

The accounting records must be sufficient to allow accounts to be prepared, identifying transactions including their amount and date, and to identify the amounts and nature of a charity's assets and liabilities. Charitable companies must ensure that their accounting records meet the requirements of company law.

## E2. What information must trustees provide?



### The short answer

The examiner is entitled to ask for any information and explanations from past or present charity trustees, officers or employees of the charity that the examiner considers necessary for the examination.

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### In more detail

The examiner has a right of access to any books, documents and other records (however kept) related to the charity and which are considered by the examiner to be necessary to be inspected for the purposes of the examination.

During the course of an examination it is very likely that the examiner will need to ask some

questions or clarify matters that arise and past or present charity trustees, officers or employees of the charity are required by law to assist. The examiner is entitled to seek information and explanations on any matter that is considered by the examiner to be necessary for the purposes of carrying out the examination.

## E3. What to prepare? The requirement to prepare an Annual Report and accounts



### The short answer

All registered charities must prepare annual accounts and a Trustees' Annual Report. For financial years ending on or before 31 March 2009, those charities with a gross income which exceeds £10,000 must file their accounts and Trustees' Annual Report with the Commission. For financial years ending on or after 1 April

2009, this threshold is increased so that only charities whose gross income exceeds £25,000 must file their accounts and Trustees' Annual Report with us. It is the responsibility of the trustees to prepare and file these statements although an independent examiner may help a charity prepare them.

### In more detail

Trustees should read our CC15 series of publications - *Charity Reporting and Accounting: The Essentials* - for the relevant financial year to find out about the requirements for a Trustees' Annual Report and options for preparing accounts. Details are also provided about the information update form or Annual Return to be filed with the Commission.

Small charities, which are not charitable companies registered with Companies House, can prepare either accruals accounts or receipts and payments accounts provided their gross income does not exceed the relevant gross income threshold for their preparation. Receipts and payments accounts offer a simple and flexible alternative to more complex accruals accounts. Receipts and payments accounts are simply an analysed record of the cash received and spent in the financial year reconciling cash and bank balances held at the beginning and end of the year together with a schedule of any other assets or liabilities at the year end known as a 'Statement of Assets and Liabilities'. Our publication *Receipts and Payments Accounts Pack* (CC16) provides a pro forma layout for the Trustees' Annual Report, the receipts and

payments accounts, the statement of assets and liabilities and the examiner's report. There is also a worked example using the pack on our website at: [www.charitycommission.gov.uk/Library/investigations/sorp/sorp05exraa.asp](http://www.charitycommission.gov.uk/Library/investigations/sorp/sorp05exraa.asp)

All charitable companies must prepare accruals accounts. Non-company charities with financial years ending on or before 31 March 2009 must prepare accruals accounts if their gross income exceeds £100,000. For financial years ending on or after 1 April 2009, this threshold is increased so that non-company charities must prepare accruals accounts if their gross income exceeds £250,000. Charities preparing accruals accounts must generally do so in accordance with the SORP. However, registered social landlords and higher and further education bodies have their own SORP and should use that instead, but the size of these organisations is usually such that they are unlikely to be eligible for independent examination.

Accruals accounts are not simply a form of cash accounts plus debtors (money owed to the charity but not received by the year end) and creditors (money owed by the charity but not paid by the year end) because they must also

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include the cost or valuation of assets, depreciation of fixed assets, provisions, the market valuation of investments, the impairment of functional assets and other accounting adjustments and disclosures, for example, accounting for pension arrangements. Accruals accounting is a much more complex form of accounting than receipts and payments and follows the accounting rules set out by the Accounting Standards Board in accounting standards and interpreted by the SORP for the charity sector. Charitable companies must also comply with the accounting requirements of the Companies Act 2006.

For charities not requiring a statutory audit, the SORP offers a number of concessions and to assist smaller non-company charities our publication *Accruals Accounts Pack* (CC17) provides pro forma layout for the accounts, Trustees' Annual Report and examiner's report which when completed fully meets legal requirements. For both company and non-company charities, there are also several worked examples of accruals accounts on our website at:

[www.charitycommission.gov.uk/investigations/sorp/sorp05exraa.asp](http://www.charitycommission.gov.uk/investigations/sorp/sorp05exraa.asp)

## E4. Who should file the Trustees' Annual Report and accounts and when?



### The short answer

It is the responsibility of the charity trustees to file their charity's accounts with the Commission within 10 months of the financial year end.

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### In more detail

For financial years ending on or before 31 March 2009, those charities with a gross income which exceeds £10,000 must file their report and accounts with the Commission. For financial years ending on or after 1 April 2009 this threshold is increased so that only charities whose gross income exceeds £25,000 must file their report and accounts with us. The trustees are responsible for ensuring that their Trustees' Annual Report and accounts, together with the independent examiner's report is submitted to the Commission within 10 months of the financial year end. Trustees of charitable companies should note that filing with Companies House is required within 9 months of the financial year end and may find it convenient to file with the Commission at the same time.

The trustees should agree a timescale for completion of the examination with the examiner. The Trustees' Annual Report, accounts and supporting records and information should be provided to the examiner early enough to allow the examination to be completed and for the accounts to be approved by the trustees before the filing deadline.

If the trustees want the independent examiner to deal with filing then this should be agreed in writing with the examiner as part of the engagement. If the filing is likely to be late the trustees should alert the Commission before the deadline for filing expires, setting out the circumstances, the action the trustees are taking and the likely date filing will be made.

## E5. What else can trustees do to ensure an efficient and effective examination?

### The short answer

Following the guidance in this publication will help. In addition following the legal requirements, planning and preparation is also important.

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### In more detail

Preparing for the examination is important. Careful planning is the key to a successful examination. Many of the steps necessary have already been explained in this guidance - the key points to bear in mind include:

- ensuring accounting records are up to date and available;
- a Trustees' Annual Report has been prepared;
- setting a timetable for preparing the accounts and Trustees' Annual Report;
- agreeing responsibilities with the examiner, for example, who will prepare the accounts and file them with the Commission;
- agreeing a timetable for the examination with the examiner; and
- making sure trustees and key staff are available to answer questions that may arise.

Further information, including a suggested timeframe, can be downloaded at:

[www.charitycommission.gov.uk/investigations/fileearly.asp](http://www.charitycommission.gov.uk/investigations/fileearly.asp)

## Appendix 1: Calculation of gross income<sup>3</sup>

Section 97 of the 1993 Act states that a reference to the gross income of a charity: “means its gross recorded income from all sources including special trusts”. This broad definition is interpreted for administrative purposes by the Commission when setting the Annual Return requirements and making the Annual Return regulations under section 48 of the 1993 Act. This administrative definition of gross income is reviewed annually in preparation for the Annual Return process.

### **The definition of gross income (Annual Return 2008)**

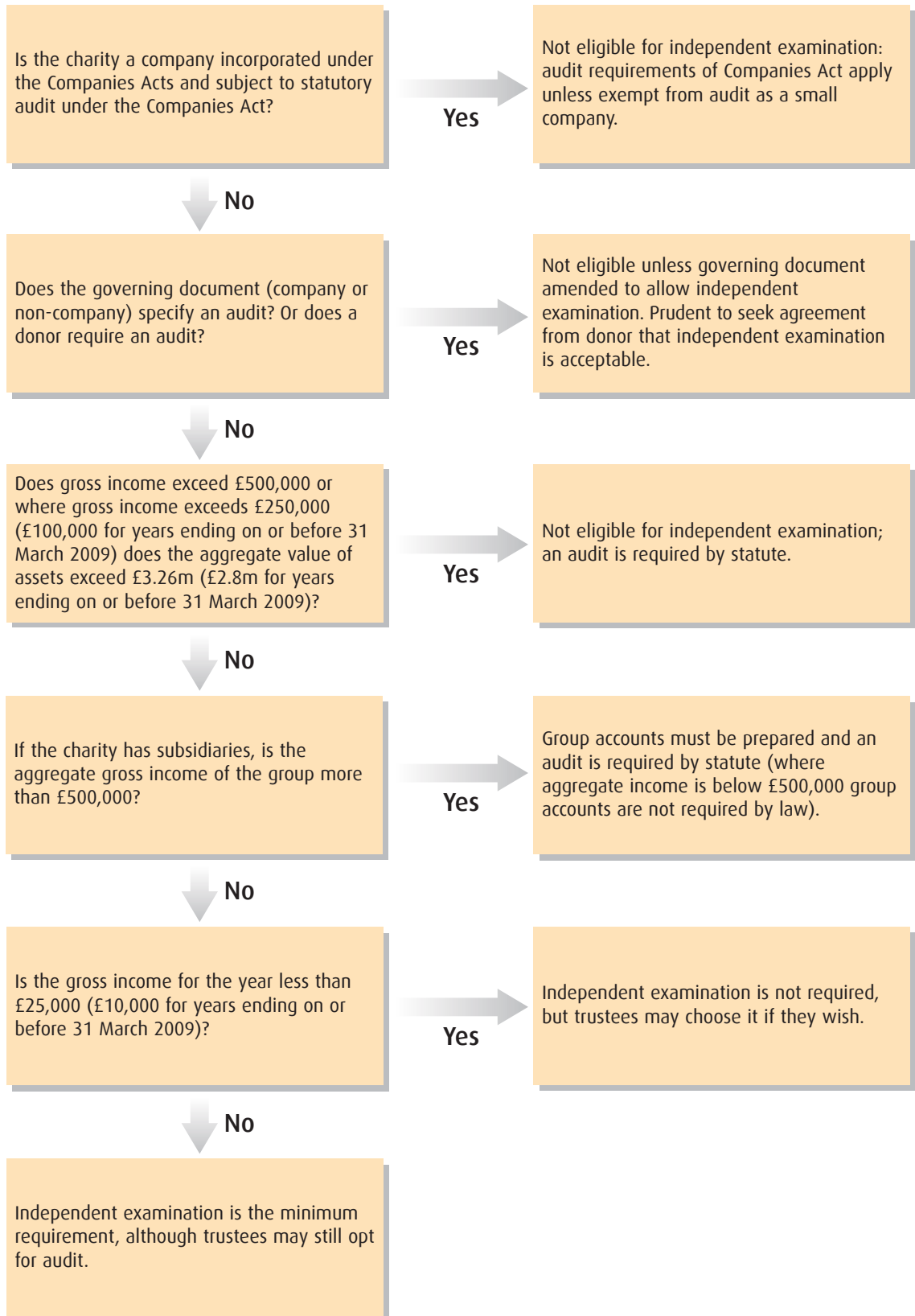
Where accounts are prepared on the **accruals basis** ‘gross income’ should be calculated as:

- the total incoming resources as shown in the Statement of Financial Activities (prepared in accordance with the SORP) for all funds but excluding the receipt of any endowment; and
- including any amount transferred to income funds during the year from endowment funds in order to be available for expenditure.

(Note that the SORP excludes from total incoming resources gains on revaluation of fixed assets or gains on investments which do not form part of ‘gross income’ for these purposes.)

Where accounts are prepared on the **receipts and payments basis** ‘gross income’ is simply the total receipts recorded in the statement from all sources excluding the receipt of any endowment.

## Appendix 2: Flowchart: Eligibility requirements for independent examination



## Appendix 3: Sources of further information

### 1. Publications

#### Accounting and Reporting by Charities: Statement of Recommended Practice

Also known as SORP 2005, this is available free on our website. A printed version of this can be obtained (cost £15 plus postage & packing) from CCH by phone 0870 777 2906 (8.30am to 5.30pm weekdays) or order online at [www.cch.co.uk/product319](http://www.cch.co.uk/product319) or email [customerservices@cch.co.uk](mailto:customerservices@cch.co.uk) quoting product code CCSORP.CCH.

#### Other relevant guidance in our CC range:

- CC15b Charity Reporting and Accounting: The essentials April 2009
- CC15a Charity Reporting and Accounting: The essentials April 2008
- CC16 Receipts and Payments Accounts Pack
- CC17 Accruals Accounts Pack
- CC32 Independent Examination of Charity Accounts: Examiners' Guide

Model Example Trustees' Annual Report and Accounts (web site only)

All of these are free.

For a complete list of all of our publications, please ask for:

#### CC1 Charity Commission Publications

To obtain copies of any of the above publications you can either:

view and print from our website:

[www.charitycommission.gov.uk](http://www.charitycommission.gov.uk)

- order during opening hours Monday to Friday 08:00 – 20:00 and 09:00 – 13:00 Saturdays by telephoning us on 0845 300 0218 ;
- write to Charity Commission Direct, PO Box 1227, Liverpool L69 3UG.

### The Regulations

The Charities (Accounts and Reports) Regulations 2008 (SI 2008 No.629) and The Charities Acts 1992 and 1993 (Substitution of Sums) Order 2009 (SI 2009 No. 508) are available from the Office of Public Sector Information website.

#### Guidance on company law requirements

The Department of Business Enterprise and Regulatory Reform publishes a number of helpful leaflets explaining the requirements of company law. These can be obtained from its web site: [www.berr.gov.uk/bbf/index.html](http://www.berr.gov.uk/bbf/index.html)

### 2. Contacts

The Association of Charity Independent Examiners brings together both professional accountants specialising in this field and others acting as independent examiners. If itself a registered charity, it may be of assistance to trustees looking to appoint an independent examiner. Further information is available from their website: [www.acie.org.uk](http://www.acie.org.uk)

The Association may be contacted at:

Association of Charity Independent Examiners  
Bentley Resource Centre  
High Street  
Bentley  
Doncaster DN5 0AA

Telephone: 01302 828338







This publication can also be accessed at the Charity Commission's website: [www.charitycommission.gov.uk](http://www.charitycommission.gov.uk)

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