



# Higher audit threshold for charities

In March 2015, the government announced changes to charity law that allow more charities to become audit exempt. The changes apply to financial years ending on or after 31 March 2015. The threshold for the audit requirement is now £1,000,000 of income.

If your charity has income between £500,000 and £1,000,000 and gross assets below £3,260,000 you may no longer require an audit. Previously this only applied to charities with less than £500,000 income. The rules are the same for charitable incorporated organisations (CIOs). **For charity groups, the audit threshold has also increased to £1,000,000.**

For charities that are now exempt from audit, they will still need an independent examination by a qualified accountant. All charities with more than £25,000 income must have an independent examination. If your charity's income is below £25,000 neither an audit nor an independent examination is required.

## Circumstances when an audit may still be required

- Certain types of charities such as Registered Social Landlords (RSLs) and NHS charities may be required by law to have an audit
- If your governing document states that an 'audit' must be carried out. This is more common in older governing documents. In many cases you can, if you wish, get the wording updated to remove this requirement

- Funders or banks may require the accounts to be audited. You must check your funding agreements
- If your charity is registered in Scotland you will still need an audit if your income is over £500,000 as Scottish charity legislation has not changed. This also applies to English charities operating in Scotland.

## What has changed?

The changes introduced:

- Increase the audit exemption income threshold to £1,000,000 for both standalone charities and charity groups
- Require consolidated accounts for charity groups only if the group income is more than £1,000,000
- Extend the list of professional accountancy membership bodies able to carry out independent examinations of charities with income more than £250,000

If you would like to discuss the new options available in relation to your charity in more detail please contact [svinfo@sayervincent.co.uk](mailto:svinfo@sayervincent.co.uk)

# Key questions and answers

## What is an independent examination?

An independent examination is a simpler form of scrutiny than an audit, but still provides an assurance that the accounts of the charity have been reviewed by an independent person. The independent examiner must have the skills and practical experience to carry out a competent examination, and must follow certain steps, or 'Directions' in carrying out the examination and make a report to the trustees setting out particular matters once they have finished their examination.

You can find further information about independent examinations on the Charity Commission's website, including *CC31 – Independent Examination of Charity Accounts: Trustees' Guide* <http://bit.ly/1CiDi5Z>.

Please be aware that as at 13 April 2015 this has not been updated to reflect the changes in audit threshold due to start on 31 March 2015, but otherwise the information is still valid.

## What are the benefits of an independent examination?

Because an independent examination is simpler for all concerned, it will usually take less time and cost less than an audit. However, it does not give the same level of assurance as an audit. See appendix C for more about the differences between audit and independent examination and appendix B for more about the benefits of audit.

## I have a charity with income under £1,000,000. How will the changes affect me?

You can now choose whether to have an audit or not. You'll have to check what your funders and trustees want, but legally you do not have to have an audit. If you opt for an independent examination, you still need an accountant to carry this out if your income was more than £250,000.

## Qualification for audit exemption

To qualify for audit exemption there are two tests:

- Audit exemption 'income test' threshold of £1,000,000
- Audit exemption 'asset test' with an asset limit of £3,260,000 and an income limit of £250,000 which has not been altered

In addition to the above tests, the governing document of the charity should not require an audit, but you can change this aspect of your governing document. Other stakeholders may require an audit, such as grant-making bodies or lenders.

For avoidance of doubt, for accounts prepared on an accruals basis the charity's gross income should be calculated as the total incoming resources as shown in the statement of financial activities (SoFA) for all funds, but excluding the receipt of any endowment.

## Is the rule on audit exemption the same for charitable companies?

Where the charity is registered as a charitable company they must follow not only charity law but also company law. Under company legislation, a company must also qualify as small. The qualification criteria for a small company is highlighted in Appendix A. In addition, if 10% of shareholders continue to request an audit, the charitable company must have an audit.

## My charity has only £20,000 of income – do I need to do anything?

Charities with income under £25,000 require neither an audit nor an independent examination, but you can choose to have one or the other.

## Our charity group has income of less than £1,000,000. How do the changes affect us?

You will no longer have to have an audit, nor will you have to prepare consolidated (group) accounts. You can, of course, choose to prepare group accounts and have them audited, but you will need at least an independent examination and you must still file accounts with Companies House and the Charity Commission in the correct format.

## I would still like to have group accounts prepared even though group income is below £1,000,000. Is this possible?

Yes, group accounts could still be prepared if requested by the trustees.

## Our charity is registered in Scotland as well as in England and Wales, does this affect us?

The update to legislation is for charities registered in England and Wales only. If a charity is a cross-border charity and registered in Scotland, then the rules have not changed and an audit (and group accounts if applicable) will still be required above the threshold of £500,000.

## Can I change my charity's year end to benefit from these rule changes?

Charities with a year end of 31 March can take advantage of the rule changes in 2015, as can all charities with a year end after 31 March 2015. There should not be a need to change your year end as the legislation has been enacted quickly.

## Are there any other factors that I should consider?

There are many alternative views on the value of the audit process, in particular to charities. You need to make a decision in the best interest of all stakeholders. We have set out some of the factors that you may wish to consider in relation to the benefits of the audit process in appendix B and highlighted the differences between an audit and an independent examination in appendix C.

## Appendix A – Small company criteria

These are the thresholds under company law which are updated from time to time.

### Individual company limits

	Small company limits
Turnover not more than	£6.5m
Balance sheet total not more than	£3.26m
Number of employees not more than	50

Balance sheet total means total gross assets (fixed assets and current assets).

### Two year rule

Two of the three limits above must be met, for the current year and the preceding year. A company can also be treated as small if it qualified as small in the preceding financial year and two of the three criteria are met for either the current or the preceding year.

# Appendix B – Benefits of the audit process

## Assurance

For trustees an audit provides you with assurance by giving you increased confidence regarding the:

- Reported figures
- General financial position of the charity
- Financial basis for making decisions
- Reliability of the accounting system and the information it produces
- Early identification of trends that could lead to future problems

## Credibility

The more credible the financial information, the more useful it is. Adding an audit report to a set of accounts increases their credibility. This helps greatly when dealing with:

- Grant making bodies
- Banks and other lenders
- Hire purchase and leasing companies
- Suppliers of goods and services
- HM Revenue & Customs and other government agencies

Some lenders may require an audit as a condition of any grant or loan. Those charities considering taking advantage of the expected rule changes must ensure that by not providing audited accounts they are not breaching banking covenants.

A track record of credible financial information could be a significant advantage in the future for finance raising, winning new service contracts and bidding for grants. It could help to avoid additional future expense.

## Advice from auditors

An auditor's involvement enables them to understand your charity and as a result provide quality advice in areas such as:

- Improvements to the accounting process
- The VAT position and planning opportunities
- Operational and managerial issues such as contractual arrangements etc.
- Improvements in systems and controls
- Maintaining good corporate governance
- Complying with government regulations

- General financial issues such as cutting the cost of borrowing, cash flow management etc.
- Benchmarking your charity against others to identify any changes required and the direction in which the charity should be going

The auditor should also be providing support to the management team, helping them with advice during the year and the year end process.

## Fraud

While an audit cannot guarantee to detect all fraud it is an important tool in helping its prevention. An audit will:

- Act as a deterrent to potential fraudsters
- Help to detect frauds involving significant amounts
- Provide positive advice where controls and financial systems need to be improved to prevent fraud

The work of an external auditor is an important part of the control environment established by the trustees. Without an audit you would need to consider how the level of control would be maintained.

## True and fair view

Unless your income is below £250,000 and you are not a charitable company, your accounts will need to comply with all the requirements of accounting standards, charity law and also potentially company law. This involves both time and expertise. The Charity Commission and Companies House continue to reject accounts that are not compliant. The audit process acts as a control for ensuring your accounts comply with relevant legislation and accounting standards.

## Taxation

An auditor will be able to assist you to ensure that:

- Information submitted to HM Revenue & Customs is reliable
- Both charity and subsidiary is compliant with all tax requirements

## Costs of an audit

You can save money by dispensing with the audit, so it worth having a conversation with your auditor to see if you can retain the aspects of the all-round service that you need and value, but cut back on the aspects that provide only compliance. You may still need to pay for an accountant to prepare year end accounts to comply with charity and company legislation, and you'll have to pay an independent examiner's fees (if applicable).



## Appendix C – Audit or independent examination?

Both of these engagements aim to give trustees assurance and both provide an opinion on a written report for you as trustees. However, an audit gives **reasonable** assurance whilst an independent examination gives **limited** assurance.

### Audit

An audit involves verification of transactions and balances to ensure that the report and accounts can be relied upon by readers. An auditor seeks evidence that the accounting records are complete and accurate, for example, checking that all the equipment actually exists and matches the records. Typically, an audit will involve a team of auditors verifying all aspects of the organisation's financial transactions and checking that the systems to process income and expenditure are fit for purpose. An auditor will also seek evidence from external sources, such as banks, investment managers and fulfilment agents.

### Independent examination

An examination involves a review of the accounting records and checking that the accounts have been properly prepared from those records. Sometimes the independent examiner also prepares the accounts from the accounting records, so this step is unnecessary. The examiner also reviews of the accounts and considers any unusual items or points that should be included in the notes. The examiner only checks the records back to original documents such as invoices where there seems to be a discrepancy or a query. The examiner is not undertaking an audit and so is not required to consider fraud or to test the internal financial controls operating in the charity. The Association of Charity Independent Examiners (ACIE) is a good place to start when looking for an examiner. More details can be found on the website at [www.acie.org.uk](http://www.acie.org.uk).

### Reporting

An audit report states that the accounts show a 'true and fair view' while an independent examination report states that nothing has come to the examiner's attention that accounting records have not been kept and that the accounts have been prepared to comply with accounting requirements.

Further information about Independent Examination can be found on the Charity Commission's website, including *CC31 – Independent Examination of Charity Accounts: Trustees' Guide* <http://bit.ly/1CiDi5Z>.

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