Do you need an audit?

Social enterprises

There isn't a particular legal form for social enterprises, but they are typically companies and may also be a Community Interest Company (CIC). The general company rules apply.

Under company legislation, a company that qualifies as small (see below) may be exempt from audit. If 10% of shareholders request an audit, the charitable company must have an audit, and there may be other reasons why you might want an audit, such as funder requirements or good governance. This is discussed further below.

Small company thresholds

These are the thresholds under company law which are effective for financial year commencing 1 January 2016. The threshold for periods before that date are shown in brackets.

	Small company limits
Turnover not more than:	£10.2m (£6.5m)
Balance sheet total not more than:	£5.1m (£3.26m)
Number of employees not more than:	50

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

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.

Charities

Many people assume that all charities have to be audited, but if your income is below certain thresholds, then you may only need an independent examination. In fact, if your annual income is below £25,000, you do not need any form of external scrutiny. The detailed rules for charities are on the Charity Commission website, but we have drawn up this note to help you weigh the advantages and disadvantages and choose the right option for your charity.

When is an audit needed?

- Charities with annual income over £1,000,000 – this applies to charitable incorporated organisations (CIOs) and charity groups as well.
- Charities with assets worth more than £3.26 million and annual income of more than £250,000.
- 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 should check your funding agreements.

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- Charities registered in Scotland still need an audit if their income is over £500,000 as Scottish charity legislation has not changed. This also applies to English charities operating in Scotland.

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. **Note this may not have been updated for the threshold changes in 2015, but is otherwise relevant.**

All charities with annual income of £25,000 or more must have an independent examination.

An independent examination is currently simpler and usually takes less time so it costs less than an audit. However, it does not give the same level of assurance as an audit.

If your charity has annual income below £1,000,000 you can choose whether to have an audit or an independent examination. 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 a qualified accountant to carry this out if your income was more than £250,000.

You can find an independent examiner through the Association of Charity Independent Examiners.

What is the difference between an audit and an independent examination?

Both of these engagements aim to give trustees assurance and both provide an opinion in a written report to the 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. The examiner reviews 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 required to consider fraud or to test the internal financial controls operating in the charity.

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.

Benefits of an audit

Assurance

An audit provides trustees with assurance by providing 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. 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). At Sayer Vincent, we offer a subscription service for advice and support to charities that are not having an audit, so you can still access seminars, updates and advice.