

NOTES FOR RESPONSE TO CONSULTATION PAPER ON CHARITY ACCOUNTING REGULATIONS ISSUED BY THE SCOTTISH EXECUTIVE 11 APRIL 2005

The Scottish Executive states its belief that for regulation to be effective it must be drawn up in line with the following five key principles:

- independence
- proportionality
- accountability
- transparency
- consistency.

We agree with these principles and the responses below are given in the spirit of a desire to promote these principles as far as is practicable.

RESPONSES TO QUESTIONS FRAMED IN CONSULTATION DOCUMENT

1 THRESHOLDS - WE WOULD LIKE YOUR VIEWS ON WHETHER THE PROPOSED THRESHOLDS ARE THE RIGHT ONES AND WHETHER THERE SHOULD BE A THIRD CATEGORY OF CHARITY FOR WHICH INDEPENDENT EXAMINATION IS OPTIONAL.

1.1 General comments

- We agree with the principle of aligning thresholds for accruals accounting and audit to eliminate unnecessary confusion. We support the general proposal that the regulations should be kept as simple as possible.
- We have reservations about the proposition that there is no need for an asset threshold alongside the income threshold. Grant giving charities in particular can have modest income and expenditure but have some very substantial investments which require suitable accountability, and this means an audit. Having said that, we recognise that there are charities with assets for which it may be difficult to obtain a market value (such as "heritage" assets) and it may be difficult to distinguish between investment charities (where we would want an audit) and other charities which might get caught unnecessarily. On balance we support the proposal not to include an asset threshold.
- Culturally it is difficult to argue with the proposition that thresholds should be set according to what Scotland believes is right for charities of given sizes in the context of Scotland's regulatory environment and culture, and that Scottish thresholds may therefore differ from English ones without there necessarily being a difference of principle. Having said that, we do not believe that there is, in fact,

a cultural difference between the two countries in this area. We do not believe that charities in Scotland should be subject to different thresholds, and hence different regulation for identical charities on either side of the border. Thus while we support the principle that different circumstances in the two countries may lead to different levels of regulation, we hope that artificial differences are not introduced for the sake of it. In particular we deplore any suggestion that the thresholds should be set having regard to the numbers of charities which will or will not be regulated. The numbers are not important. The need for the regulation (or not) is the sole criteria which should be applied.

- We agree that it is a good idea to have a memorable, simple figure and that £250k is memorable and simple.

1.2 Accruals threshold

- We do not agree that the skill required to prepare fully accrued accounts is not readily available to charities below the £250k proposed threshold. These skills are not in short supply and can be readily bought if not available voluntarily.
- We do not agree that charities with income less than £250k are rarely likely to have transactions that would make receipts and payments accounts misleading. Whether accounts will appear materially different on a receipts and payments basis depends entirely on the nature of the entity e.g. small grant maker with grants committed forward could have very different accounts on either basis.
- We agree that small charities are unlikely to have complex transactions, but it is not the complexity of the transactions that determines whether the financial statements will look different prepared on either an accruals or receipts and payments basis. Accounts (and balance sheets in particular) prepared on an accruals basis may look significantly different from those prepared on a receipts and payments basis, and this makes understanding of their true financial position more difficult, and makes comparison between charities potentially impossible.
- We would like to see the accruals threshold remain at £25,000.

1.3 Audit threshold

- We agree that the more the accounts rely on judgement the less appropriate it is to substitute examination for audit, but do not see a clear connection between this and the proposed threshold figure arrived at.

- We agree that audit and independent examination are a vital component of public confidence in charities and so should be universal and agree with the proposal not to exempt very small charities from independent examination (IE). This will also minimise the confusion that arises from multiple categorisations.
- The proposals state that the £100k threshold is widely agreed to be too low because the minimum fixed cost of an audit is too high in relation to income. The cost of an IE by a professional firm is similar to that of carrying out an audit. If demand for IEs increases on implementation of these proposals, the voluntary sector may be unable to meet this demand in full, and small charities may end up paying a similar amount under the new regime as they currently are for an audit.
- With these caveats, we support the raising of the threshold to £250,000.

2 UK CHARITIES - DO YOU THINK THAT THE APPROACH TAKEN TO UK WIDE CHARITIES IN THE PROPOSALS IS THE RIGHT ONE?

- 2.1 We agree with the approach taken to UK wide charities in the proposals and note that this is unlikely to affect many charities.

3 EXEMPTIONS - WE SEEK YOUR VIEWS ON WHETHER THIS IS THE RIGHT APPROACH AND WHETHER THE RIGHT CHARITIES ARE GIVEN EXEMPTIONS

- 3.1 We agree with the approach to exemptions in the proposals.

4 DESIGNATED RELIGIOUS CHARITIES - DO YOU AGREE WITH THE PROPOSAL THAT DRCS FOLLOW THE SAME ACCOUNTING REGULATIONS AS OTHER CHARITIES IN SCOTLAND?

- 4.1 We agree with the proposal that DRCs follow the same accounting regulations as other charities in Scotland.

5 CHARITABLE COMPANIES - DO YOU AGREE WITH THE PROPOSALS THAT THE AUDIT THRESHOLD FOR CHARITABLE COMPANIES REMAINS AT £250K PROVIDING A CONSISTENT ACCOUNTING REGIME FOR ALL CHARITIES IN SCOTLAND

- 5.1 We agree with the proposal that the audit threshold for charitable companies remains at £250k providing a consistent accounting regime for all charities in Scotland.

6 ACCOUNTING PERIODS - DO YOU AGREE WITH THE PROPOSALS ON THE ACCOUNTING PERIODS, THE TIMEFRAME FOR SUBMITTING ACCOUNTS AND THE ACTIONS AVAILABLE TO OSCR IF A CHARITY FAILS TO DO SO?

- 6.1 We agree with the proposals on accounting periods.
- 6.2 We agree with the principle that the earlier accounts are published the more useful they are to all readers and that the filing deadline should therefore be the earliest date that can be achieved without causing undue practical difficulty or expense. The 7 month deadline is likely to have the greatest implications for those charities with December and March year ends as the tighter deadline will mean that their audits will have to take place at busier times for professional firms which may be difficult for firms to resource and may put fees up if there are practical difficulties in scheduling the audits. This may increase the cost of audit to the Charity sector, but we believe, on balance, the potential additional cost is justified.
- 6.3 We agree with the proposal to make default public and agree that OSCR should have the ability to launch an enquiry and appoint someone to complete accounts

7 ACCOUNTS IN GAELIC - IS THIS THE RIGHT APPROACH? SHOULD ALL ACCOUNTS AND REPORTS BE IN ENGLISH? SHOULD OSCR BE PREPARED TO ACCEPT ANNUAL ACCOUNTS AND REPORT IN GAELIC?

- 7.1 The proposals state that accounts must be in English but that charities may also produce versions in Gaelic for issuing to members and enquirers who prefer this. We agree with this approach as it is in line with the principles of consistency and transparency. While supportive of the wish to encourage the use of Gaelic, it would be wasteful to compel the use of Gaelic, and accepting accounts in Gaelic alone would debar the vast majority of the population to opportunity to read and understand these accounts thereby denying the key principle of accountability.

8 THE CHARITIES SORP - DO YOU AGREE THAT THE REGULATIONS TAKE THE RIGHT APPROACH TO ADOPTING THE SORP?

- 8.1 We agree that cross-border UK consistency is desirable and that it is essential to insist on compliance with SORP as approved by ASB for the UK. We also agree with the principle that regulations should be consistent with the UK accounting standards regime.
- 8.2 The proposal is to include key requirements for Scottish Charities in the regulations, but adhere to the methods and principles of the SORP. We believe that the specific key requirements to be included in the regulations should be kept to an absolute minimum. Clearly the SORP will change from time to time as it is revised in line with developing accounting practice and the requirements of the community. It would be undesirable if elements in the regulations were to conflict with the developing SORP, requiring a revision of the regulations. The old requirement in Scottish Charity law to prepare an Income and Expenditure account as well as a SOFA is a good example of the stultification of progress caused by the inclusion of a specific requirement in primary legislation instead of the SORP. The less there is in the regulations, the less likely that there will be conflict or ossification. We consider that the principles of transparency and consistency would be better served by including in the regulations a requirement to follow the SORP, with little further detail included. In our opinion the detail specified in pages 23 to 31 of the draft paper are much more than is desirable.
- 8.3 However we support the establishment of a clear right to include in regulations whatever the circumstances of Scotland might require.
- 8.4 The SORP reviews are under the control of the Charity Commission for England and Wales, and Scottish involvement at present is by invitation rather than a requirement. This means that under the proposed approach, Scottish charities could be put in a position where they are required by the Scottish regulations to follow recommended practice developed in an English context. We consider that a system of joint approval and publication is desirable and that the Scottish Executive and OSCR should work to position the SORP as a UK document.

9 DRAFT REGULATORY IMPACT ASSESSMENT (RIA) - DOES THE RIA PROVIDE AN ACCURATE PICTURE OF THE IMPACT OF THE NEW REGULATIONS? DO YOU HAVE ANY COMMENTS ON THE RIA?

- 9.1 The key omission from the RIA is information around compliance costs. The draft states at page 37 that independent examinations are available "for free". That is true. What it fails to recognise is that audits are also available free of charge. The cost usually depends on the extent to which the independent examiner or auditor is a supporter of or sympathiser with the charity. It is wrong to believe that independent examinations are done at negligible cost and

audits are exclusively on a "commercial" basis. In reality the distinction is much more blurred than that.

9.2 Also, the time costs of carrying out an independent examination are not significantly less than those of carrying out an audit so again the cost differential may not be as great as the draft paper implies.

9.3 Our view therefore is that it does not follow that charities will save significant amounts of money by moving to independent examination. We believe the saving will be much more marginal.