



## **Charity Accounting Regulations**

### **A Response by the Scottish Council for Voluntary Organisations**

**June 2005**

#### **Introduction**

SCVO is the umbrella body for the voluntary sector in Scotland. Our 1200 members represent a vast constituency covering the majority of charitable activity in Scotland. This response is endorsed by the elected SCVO Policy Committee which represents large and small, local, national and international organisations, covering many different fields of activity. Nevertheless we urge all charities, and other organisations who may wish to become charities, to respond to this consultation on the draft Accounting Regulations so that their interests and views are well represented in the debate.

The accounting regulations for charities in Scotland are long overdue for an overhaul both to bring them up to date with current practice and to ensure they work most appropriately in relation to other regulatory obligations that may affect charities. Alongside the Charities and Trustee Investment (Scotland) Bill the changes to the regulations represent a great step forward in enabling a flourishing and vibrant charitable sector in Scotland and we welcome the opportunity to comment on the proposals.

Overall the proposed accounting regulations are a welcome move from the current requirements but there are still a number of issues that we feel require to be addressed.

#### **Thresholds**

We welcome the proposed change in the threshold for the preparation of accruals accounts (and hence the full implementation of the SORP) from £25,000 to £250,000 and the change to the threshold at which an audit of accounts is required to £250,000.

We believe that there is a practical case for exempting very small charities (i.e. those with an income of less than £10,000) from the requirement for independent examination. While we accept the need for transparency the limited capacity of such organisations will make it very difficult for this to

actually happen. It is counter-productive for regulations to be ignored because they have not recognised the reality on the ground and we believe an exemption for such charities is a more effective solution.

We trust that these thresholds, and others contained in the regulations, will be regularly reviewed in order to ensure that they are still relevant taking into account changes both in the financial composition of the sector and in monetary values.

### **UK Charities**

We believe that the approach outlined is acceptable.

We would expect that most UK charities would register themselves in Scotland simply for their Scottish operations and be thereby permitted to submit their UK accounts to OSCR.

This will mean that it will be difficult to gain a truly accurate overall picture of charitable activity in Scotland. However, while we believe it is *good practice* for UK charities to prepare separate accounts for Scotland (or at least to give some form of summary) in order to give a true picture of their activities here and to enable the collection of reliable statistics; we appreciate that this has significant resource implications. We therefore do not believe that separate accounts should be a regulatory requirement.

It will be important that any data which is collected makes clear whether it is referring to UK or purely Scottish activity.

### **Exemptions**

We believe that the increased thresholds will mean there will be far fewer issues and agree with the approach as outlined.

### **Designated Religious Charities**

We agree that DRCs should follow the same accounting regulations as other charities in Scotland.

### **Charitable companies**

#### ***Accruals Accounts***

Under UK Company law *all* companies (including charitable companies) must prepare accounts on an accruals basis. This means that for charitable *companies* in Scotland the introduction of the new £250,000 threshold for the preparation of accruals accounts is meaningless. In recent years there has been a steady increase in the number of organisations in Scotland opting to become charitable companies. They will not benefit from the changed threshold.

We appreciate that changing UK Company law is not within the powers of the Scottish Parliament but our understanding is that the new £250,000 threshold will not apply to SCIOs either. This means that only unincorporated bodies will

be able to enjoy the benefits of lighter regulation as represented by the new threshold.

We do not understand why SCIOs should not be permitted the same regime as unincorporated bodies. The consultation paper itself says

“We believe that the preparation of fully accrued accounts requires a level of expertise unlikely to be readily available to a charity as small as £250,000 and that they will rarely have transactions of a complexity that would make receipts and payments accounts misleading”.

We do not see why achieving SCIO status (or for that matter company status) suddenly provides the required level of expertise or means that transactions become instantly more complex to the extent that receipts and payments accounting is no longer appropriate.

Previous Scottish Executive consultation on SCIOs concentrated on the fact that they would be generally a simpler structure and subject to a much less onerous regulatory regime, than companies. The ensuing enthusiasm for SCIOs was, to a sizeable extent, based on this. Yet the proposed accounting regulations lump them together with company regulation for the purposes of accruals accounting thresholds for no clear reason.

We urge the Executive to reconsider the matter of accruals accounting thresholds, particularly with respect to SCIOs, the regulation of which it / the Parliament has, at least, the power to control.

### **Audit**

The current threshold in UK law for audit of a charitable company is already £250,000. Charitable Companies with an income of below £90,000 do not require external scrutiny under company law and with income of £90,000 to £250,000 they require an ‘audit exemption report’ from a reporting accountant.

Consequently the new Scottish regulations would bring the Scottish threshold into line with the English/Welsh one, which we think is useful.

However, if the Charities Bill at Westminster is passed the English/Welsh audit threshold is likely to be raised to £500,000. Depending on how individual charities choose to register the resulting disparity may mean that the Scottish operations of some UK charities would be required to have an audit whereas their English operations would not.

The alignment of accruals accounts and audit thresholds at £250,000 *is* useful but we see merit in further cutting bureaucracy and expense for some charities by raising the requirement for audit in Scotland to £500,000.

We appreciate that there is an argument to say that if more charities are audited there is a greater standard of accountability. However, SCVO’s own research on charity income produced for the Executive (*Analysis of Scottish Charities Sector, February 2004*) shows that raising the level to £500,000

from £250,000 would merely excuse approximately 3.8% of charities from audit. This is to be compared to the 90% whose income is below £200,000 anyway and so would already be exempt from the requirement for audit under the proposed regulations.

### **Accounting periods**

We cannot agree at all with the proposal to reduce the period within which Annual reports and Accounts must be submitted to OSCR from 10 to 7 months.

10 months accords with the established best practice of most charities and company law and with the requirements of the Charity Commission. To make this change would cause totally unnecessary upheaval and reorganisation of activity for all charities in Scotland whether they are unincorporated, a company or a UK charity registered in England.

We are absolutely sure that OSCR has sufficient resources to cope with the effect of a 10 month period, which, although the maximum limit allowed, does not preclude an earlier submission if a charity is able to make one. OSCR should encourage submissions to be made sooner than 10 months but there should not be a regulatory requirement to do so.

### **Accounts in Gaelic**

We do not oppose such a measure but it is surely the case that, given the diverse Scotland in which we now live, there should be a permission (but not a requirement) to make the accounts available in whatever language is appropriate in the circumstances (e.g. Cantonese, Urdu etc).

### **Charities SORP**

We understand that the Executive now recommends Option 3 as set out on page 42 of the consultation document (which rather confusingly appears as Option 2 on page 17 of the consultation document).

We appreciate that the Executive's intention in recommending Option 3 is to enable it to produce straightforward accounting regulations that, for certain requirements, rely on the SORP when the SORP provides the best approach to use in order to meet those requirements. Within the SORP there is an over-riding requirement to give a true and fair view which is not reflected in the regulations. Each recommendation within the SORP has to be considered in the context of what is material. There is no mention of either requirement in the regulations.

At first sight it might look simple to, on the one hand, have a set of regulations that in certain instances say: 'refer to the latest SORP because whatever it says is the right way to do it' and on the other hand the SORP, just bursting with good practice to cherry pick when appropriate. The SORP is, of course, established by the SORP committee, not Scottish Ministers, which would presumably mean that even if the SORP changed the regulations would not have to; as they would forever say something like 'refer to the latest SORP etc'. This would in effect give legal force in Scotland to whichever version of

the SORP was current. We appreciate that that is not necessarily a bad thing, if one sees the SORP as genuine best practice, as the Executive clearly does. There is much to be said for seeing it that way.

The problem is how to actually execute this relationship between Scottish regulations and the SORP in the real world. It already seems to be unraveling with respect to the draft regulations in the consultation document. For example:

On page 24 the draft regulation says “All items (in the SOFA) must be measured, calculated and categorized according to the definitions, methods and principles in the Charities SORP”.

The next paragraph then launches into a 3 page list of what categories of transaction must be shown in the SOFA. This is confusing for the reader as they have just been directed to the SORP on these points. In fact, the categories that must be shown in the SOFA are dealt with comprehensively in SORP 2005 over some 24 pages (SORP 2005, pp. 13 to 37)!

Why do the regulations need to contain both a reference to the SORP as well as some kind of ‘summary’ of the same issues? Surely, given the Executive’s preferred option, the reference to the SORP is enough? If the summary contained in the regulations is supposed to be the ‘clear requirement’ spoken of in Option 3 then why bother referring to the SORP in this section at all?

In practice a charity would have to set the regulations side by side with the SORP and double check that (since the headings, wording and level of detail differs between the regulations (as drafted) and the SORP) they had complied with all the permutations of both documents, even if they are more or less identical. And if they are more or less identical –and if the intention is that they should be so – why is there a need for two versions?

We wonder whether there is a legal issue here whereby it is not permissible for statutory regulations to solely refer to another (non-statutory) document and the ‘summary’ approach is meant to get round this.

Either that or the Executive feels that the regulations should provide a simpler version of what’s in the SORP because the SORP is so fiendishly complicated.

Either way to have two versions (however similar) of the same requirements does not provide the clarity the Executive says it intends. Clarity would be provided by clear concise statutory regulations *based* on the SORP but which could account for the Scottish context perhaps containing a *blanket* caveat such as ‘for further assistance in interpreting these regulations charities should refer to the current Charities SORP’. Thereby the regulations would still have clear legal primacy and where the regulations were clear enough on any given matter it would not even be necessary to refer to the SORP.

This may simply be a description of Option 3 as the Executive sees it but the draft regulations don't make it look like its being executed that way in practice.

It is also an unavoidable fact that if the regulations are linked to the SORP in any other way than simply by using the SORP as a *non-binding reference to help elucidate the regulations in instances of possible obscurity*, then the regulations will have to be changed to some degree (even if it's a small degree) every time the SORP is changed.

We need only look at paragraph vii on page 26 of the consultation to see an example of how this would work in practice. The draft regulations quote exact figures with respect to emoluments: 'bands of £10,000 above £50,000'. These figures do not correspond with SORP 2005 which gives 'bands of £10,000 above £60,000' (p. 36).

Option 2, as we understand it, got round the problem of 'dual primacy' by relying primarily on the SORP rather than on regulations. It also meant that charities may benefit from certain leeway provided by the SORP in some instances, which could be helpful. However, we appreciate that there were some disadvantages to Option 2 as outlined in the consultation document (no Scottish consideration, no detail for receipts and payments etc).

The point is that whatever option is chosen – or if a new one is identified – the regulations must be as clear as they can be. They must not create a situation where there can be any confusion between the requirements of the regulations and the requirements of the SORP. If the regulations are to be identical to the SORP then they should use identical language. If not they should be clear that they are different. And if somewhere between the two they must be written out in such a way as to make it absolutely clear, as if to a child, which parts of the regulations are definitive and which parts are simply duplicating the requirements of the SORP. In any case, the unavoidable need to alter the regulations in light of changes to best practice (as exemplified in the SORP) must be built into the long term future of the regulations in terms of the resources attached to them such as they may be (redrafting, republishing, publicity etc).

It is also vital that in the sections covering the SORP and the Statement of Financial Activities the point is reiterated that it does not apply to smaller Charities.

We further suggest that the Executive considers whether or not to leave open an option to ultimately prepare a separate Charity SORP for Scotland. This may provide the opportunity to overcome some of the difficulties noted above as well as some of the criticism that has been directed at the SORP, particularly that, for all the good intentions of its creators, it - and the accounts that result from its use - are almost totally incomprehensible to anyone but an accountant or other financial specialist.

## **Other Matters**

## ***The Reporting Regime of the Office of the Scottish Charity Regulator (OSCR)***

OSCR's proposed monitoring regime will ultimately introduce a two tier reporting structure. Charities with an income below £25,000 will have to fill in a short 'annual return' and those with an income above £25,000 will have to fill out a longer 'monitoring return' as well.

SCVO's understanding is that OSCR has committed to ensuring that the information that will be required to fill out the 'monitoring return' will be easily drawn from a charity's accounts, whether those accounts are prepared on an receipts and payments basis or on an accruals basis.

If this is indeed the case we see no problem. An earlier concern of ours had been that a substantial number of the questions to be asked in the monitoring return could only be answered with reference to information that a charity would have collected as a result of preparing its accounts *on an accruals basis following the SORP*. That would have meant that a large number of charities (those with income *less* than £250,000) would have been obliged to undertake accruals accounting *despite* the £250,000 threshold in the accounting regulations, simply to be able to satisfy OSCR's requirements.

In any case, we urge the Executive and OSCR to work together to make sure that the regulatory regime provided for by the regulations and that provided for by OSCR accord with one another and do not cause charities to have to produce different sets of information in different ways for no obvious benefit to anyone. If it would be helpful, SCVO would be glad to assist with such a joint working process.

### ***Funders***

We are mindful that the Strategic funding Review of the Voluntary Sector is yet to be fully completed and that measures to assist funders in dealing with the sector effectively may yet be put forward.

However, it is still common practice for too many funders to require their funds to be accounted for in a way that is often hardly justifiable in terms of the relatively small amounts given, however large some funders perceive those amounts to be. Funders often seem to have no understanding of the administrative cost associated with financial record keeping or the cost of conducting an audit and still less are they inclined to cover those costs as part of their grant or donation.

We would therefore urge the Executive and OSCR to publicise the new accounting regulations specifically to funders as a way of spreading best practice as widely as possible and of convincing funders that it is completely possible to properly account for funds within much simpler accounting regimes than many of them currently seem to think.

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