



## **Charity Audit and Independent Examination Factsheet**

A guide for clients

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## New audit exemption limits for charities

The Government has recently announced changes to charity law that will allow more charities to become audit exempt. The changes apply to financial years ending on or after 31 March 2015.

### Who is affected?

Broadly, there are two main types of charity which are affected by the changes:

- standalone charities with income between £500,000 and £1,000,000 where gross assets are below £3,260,000;
- charity groups with income between £500,000 and £1,000,000.

### What has changed?

The changes introduced:

- increase the audit exemption income threshold to £1,000,000 for standalone charities;
- align the group audit thresholds with the above income threshold (£1,000,000) and increase the requirement for consolidated accounts to be produced to the same level; and
- extend the list of professional accountancy membership bodies able to carry out independent

The lower limits for independent examinations have not altered. So charities with income above £25,000 but below £1,000,000 will usually be audit exempt, but will still require an independent examination which is less detailed and a lower level of external scrutiny. For charities with income below £25,000 no external scrutiny is usually required.

### How can we help?

These changes remove the legal requirement to have a statutory audit for many more charities and therefore provide us with an opportunity to provide you with a more flexible service.

There are, as always, a number of legislative details and other factors to consider before a decision can be made to dispense with an audit. We have included the answers to some of the key questions that you may have. If you would like to discuss the options available to your charity in more detail please contact us.

## The differences between audit and independent examinations

Both of these engagements are assurance engagements however an audit gives *reasonable* assurance whilst an independent examination gives *limited* assurance.

An assurance engagement leads your auditor / independent examiner to provide an opinion on a written report for you as trustees, but it's the conclusion (opinion) which is different. An audit report states that the accounts show a 'true and fair view' whilst an independent examination report broadly 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.

An independent examination therefore gives a lower level of assurance and is stated in 'negative' terms.

Although the assurance is much more limited with an independent examination, this type of assignment does allow the examiner to take a more flexible approach to the assignment as the rules outlined by the Charity Commission for independent examinations are less prescriptive than those that need to be followed for an audit.

But we are finding trustees still want the added comfort of an audit to reassure them that their governance responsibilities are being met in this regard. External bodies such as grant providing may still require an audit.

## Key questions and answers on the new audit exemption limits for charities

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

Previously for charities with income over £500,000 an audit was always required. If income was over £250,000 but gross assets were above £3,260,000 an audit was also required. If income was below £25,000 there was no external scrutiny requirement and anything in-between required an independent examination.

#### **Qualification for audit exemption**

Under the changes to charity law, to qualify for audit exemption there are two tests:

- Audit exemption 'income test' threshold of less than £1,000,000; or
- Audit exemption 'asset test' with an asset limit of £3,260,000 and an income limit over £250,000 which has not altered.

Due to the significant increase in the 'income test' threshold from £500,000 to £1,000,000 it is expected that a significant number of charities will now become audit exempt.

In addition to the above tests, the governing document of the charity must be reviewed in order to highlight whether an audit is still required. This is an essential test for any charity as older governing documents often stipulate the need for an audit.

It is also important to remember that other stakeholders of the charity may request an audit. This is particularly common when dealing with grant making bodies and may also be relevant for large donors or lenders of external finance.

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 endowment.

### 2. Is there any difference to the above if the charity is a charitable incorporated organisation (CIO)?

No the audit exemption rules for CIOs stem from Charity legislation and thus are the same as above.

### 3. 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, the charitable company must also qualify as small. The qualification criteria for a small company is highlighted in Appendix I.

In addition, the following rule must be considered:

- If 10% of shareholders (members) continue to request an audit, the charitable company is not eligible for audit exemption.

**4. It appears that I now may be audit exempt in the future, does this mean that I no longer need any form of external scrutiny?**

Unless the charity has income under £25,000 then an independent examination will be required. Charities with income under £25,000 do not require any external scrutiny although charities can request either an audit or an independent examination.

**5. I have a charity group with income of less than £1,000,000. How are the changes expected to affect me?**

We noted above the audit exemption criteria for standalone charities. There have been similar changes in a group situation for audit exemption and also for the preparation of group accounts. The rules for preparation of group accounts are set at the same limit as the group audit exemption threshold which historically sat at £500,000 and which coincides with the standalone charity audit exemption 'income test'.

***Qualification for audit exemption***

Under the changes to charity law, to qualify for group audit exemption there is one test:

- Audit exemption 'income test' threshold of £1,000,000 giving an increase of £500,000 from the previous limit.

If the parent is a charitable company then the group must also qualify as a small group in relation to Company law.

As noted above, the preparation of group accounts has previously been set at the same limit as the group audit exemption limit and thus with the above change the threshold for preparation has also increased to £1,000,000.

**6. 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.

**7. Our charity is registered in Scotland as well as in England and Wales, how does this affect me?**

The update to legislation is for charities which are registered in England and Wales, ie. under the Charities Act 2011. If a charity is a cross border charity and thus is registered under another jurisdiction such as Scotland then the charity has to follow the rules under both pieces of legislation.

***Standalone charity***

Scottish legislation has the following audit exemption limits:

- Audit exemption 'income test' threshold of £500,000; or
- Audit exemption 'asset test' with an asset limit of £3,260,000 and an income limit of £250,000.

As such if the charity is a cross border charity and has income in the region of £500,000 to £1,000,000 with assets below £3,260,000, although it would not require an audit under English and Welsh charity legislation, it would continue to require an audit under Scottish charity legislation.

### ***Group position***

The group position in Scotland is that group charities with income over £500,000 require consolidated accounts to be produced and to be audited. With the changes noted above to English and Welsh charity legislation it will mean charity groups with income between £500,000 and £1,000,000 will become audit exempt in England and Wales but will still require an audit and for group accounts to be prepared under Scottish legislation.

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

A large number of charities have a 31 March year end and these charities will be able to benefit from the rule changes this year.

Unlike corporate entities, charities do not tend to alter their year end date and it is not anticipated that charities will change their year end given that The Charities (Accounts and Reports) Regulations 2008 states that trustees may exercise their power to determine accounting reference dates less, or more than 12 months from the beginning of the year only where there are exceptional reasons to do so.

## **9. 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. The decision for you and your charity clearly needs to be decided 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 on the next page and highlighted the differences between audits and independent examinations on page one. All charities may, of course, choose to continue to have an audit.

## The benefits of the audit process

A number of our clients continue to want an audit because:

### Assurance

As a trustee, an audit provides you with assurance by giving you increased confidence regarding:

- the reported figures;
- the general financial position of the charity;
- the financial basis for making decisions;
- the reliability of the accounting system and the information it produces; and
- the 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; and
- HM Revenue & Customs and other government agencies.

Some lenders or grant providers may require an audit as a condition of any grant / 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

Our involvement enables us 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; and
- benchmarking your charity against others to identify any changes required and the direction in which the charity should be going.

The benefits of the close involvement of an independent financial expert should not be underestimated. Our presence via the audit process provides support to the management team.

## Fraud

Unfortunately fraud continues to be an ever present part of charity life. Whilst the audit cannot guarantee to detect all fraud it is an important tool in helping its prevention. An audit will:

- act as a deterrent to the potential fraudster;
- help to detect fraud which has a significant effect on the accounts; and
- 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. Our involvement in the audit process acts as a control for ensuring your accounts comply with relevant legislation and accounting standards.

## Taxation

Although charities themselves are generally exempt from corporation tax, if there are corporate subsidiaries within a group scenario then tax law never seems to become any simpler! Without an audit we would need to spend time ensuring that:

- the information submitted to HM Revenue & Customs is reliable; and
- the charity is not breaking any of the ever widening tax requirements.

## Costs of an audit

There are, of course, costs involved in the audit process and corresponding savings to be made in dispensing with an audit. The degree to which costs may be saved depends upon a number of factors, as the audit fee typically only represents part of our total charges.

How much of the fee relates to the audit will depend upon the individual circumstances of your charity. We will, of course, discuss potential cost savings with you before you make your decision. Indeed, when considering the factors above you may value some aspects of 'audit' work more than others. As mentioned earlier, these new rules enable us to deliver a more tailored service to those affected.

## **Our audit service**

### **Our audit philosophy**

Our audit philosophy is to provide all our clients with a professional, quality service in a cost effective and timely way. We believe the way we conduct the audit will impress you as you engage with the knowledge and skills sharing we will give you. Having so many audit clients, our particular approach allows us to apply the experience gained at one client throughout the rest of our client base.

Our approach to deliver on this involves:

- Achieving a clear understanding of your organisation, your aims and operations
- The adoption of auditing techniques to meet the audit objectives
- Clear and helpful advice in a findings letter in plain English, jargon free!

We aim to be highly collaborative with your own finance team to minimise their time involvement in the audit and always consult carefully & early with our clients on any significant issues arising from the audit.

As a normal part of our reporting, through our audit findings letter and, if requested, in a presentation to the management or other committee, we try hard to provide added value, identifying and communicating issues that came to our attention, not only during the audit process, but also throughout the year.

### **Audit quality and methodology**

We are registered with the Institute of Chartered Accountants in England and Wales (ICAEW) for the conduct of audits.

We use specialist audit programmes recommended by the Institute of Chartered Accountants. This allows us to fulfil our duties to a proper professional standard and to give you the added comfort that your responsibility for the preparation of the accounts has been met.

Our audit processes are reviewed annually for us by an independent external agency. At our latest review visit by the Quality Assurance Department (QAD) of the ICAEW, they expressed themselves happy with the quality of work we do and the procedures & protections we had in place, with the QAD Reviewer saying that our audit work & methodology etc. is as 'good as it gets'.

We will agree and send a summary of the detailed records that should be gathered together before we begin our audit work. This will ensure that our work is performed as efficiently as possible to keep our costs down, and minimises your own time input. On-going we ensure as part of our routine year end planning with the client staff that the information we need is clearly identified, respective responsibilities agreed, and timetable mapped out. We find this works well both for us and the client.

We carry out as much of our work at your premises as is practicable and efficient, space permitting. This disciplined approach helps to ensure that the process runs smoothly to mutual satisfaction.

## **Our Independent examination service**

An Independent Examination is carried out by an individual, called an Independent Examiner, who will:

- Look at your accounts
- Gain an understanding of the organisation
- Compare the accounts to the books, perform various other checks including analytical procedures, events occurring after the year end
- Record the procedures carried out
- Review the accounting records
- Review the trustees' report
- Write an independent report for circulation with the accounts

The procedures are laid down by Act of Parliament, by detailed Regulations, and (in England & Wales) by the Directions of the Charity Commission. Guidance is available on the Charity Commission website [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk).

**For more information please contact Lesley Malkin.**

## **FOR GENERAL INFORMATION ONLY**

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

### **About Us**

#### **Professional, Personal, Affordable.**

We are one of the leading, independent chartered accountancy practices in Liverpool. At BWM we provide a wide range of accountancy and business support services to organisations and individuals throughout the North of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your business, please visit [www.bwm.co.uk](http://www.bwm.co.uk) or call us on 0151 236 1494.