Presentation of the key findings from research on trustees' annual reports and accounts filed with the Charity Commission for England and Wales (CCEW): 9 November 2020

Cover paper for the research papers used in the presentation

The presentation draws on the following research carried out by CCEW:

Published reports:

- Auditors' and independent examiners' compliance with their responsibilities
- Reserves policies: demonstrating and building resilience

Unpublished reports:

- Are charities explaining the difference they make?
- Improving the quality of smaller charity accounts
- Pension scheme deficits
- Risk reporting in charity accounts

We prepared these versions of the reports for the SORP Committee. They may differ from the final versions that CCEW may publish in the future.

Accounts monitoring review: Auditors' and independent examiners' compliance with their responsibilities

Why are we reviewing the work of auditors and independent examiners?

The auditors and independent examiners of charity accounts are our second line of defence, after the trustees, against mismanagement in charities. We rely on them to scrutinise the accounts that the trustees have appointed them to audit or examine and to report to us any significant concerns that they identify in the course of their work. However, the results of our annual surveys of the quality of charity accounts show that some auditors and examiners are failing to identify significant failings in the accounts that they are reviewing. For more information, see [Accounts Monitoring Review: Public reporting by charities in their trustees' annual report and accounts].

In August 2019, the Commission published a benchmark of the minimum standards it expects in an external scrutiny of a charity's accounts. We based the criteria that make up the benchmark on the Charities Act 2011, the Charities Statement of Recommended Practice (SORP), auditing standards and the Commission's Directions for independent examiners. You can find details of the benchmark at [A benchmark for the external scrutiny of charity accounts].

What are the requirements for audit and independent examination?

The trustees of the approximately 64,000 charities on our register with incomes over £25,000 must arrange for either an audit or an independent examination of their charity's accounts. Charities with incomes over £1 million (and those with incomes over £250,000 and gross assets over £3.26 million) must have an audit. Most other charities can opt for an independent examination, unless an audit is required for another reason, such as by the charity's governing document.

How did we carry out the review?

We reviewed the 2017 sets of accounts filed by 296 charities to assess whether they met the benchmark. The charities were drawn from three random samples, chosen to reflect the different accounting and scrutiny requirements that apply.

What did we find?

The percentage of accounts meeting the external scrutiny benchmark

Three quarters of charities with incomes over £1 million met the external scrutiny benchmark. This fell to half or less of the charities in our two lower income samples.

Charity income	% of accounts meeting the external scrutiny benchmark
£25,000 - £250,000	37% (of 100 charities)
£250,000 - £1 million	51% (of 100 charities)
£1 million and greater	76% (of 96 charities)

The Commission is concerned that so many accounts submissions did not meet our benchmark. Whilst the trustees are responsible for their charity's accounts, our findings also raise concerns about the work done by the auditors and examiners who scrutinised these accounts.

We looked in more detail at the results for each of the three documents that make up a set of charity accounts. All of the charities in the two largest income samples provided a trustees' annual report and nearly all of them filed an audit or independent examination report with the required wording, as did the vast majority of charities in the lowest income sample. However, compliance with the accounts criteria was much lower in all three samples. The benchmark focusses on the content of the accounts, since this reflects the scope of an audit or examination.

Income/ % of accounts meeting criteria	Trustees' annual report	External scrutiny report	Accounts	All 3 documents
£25,000 - £250,000	90%	74%	44%	37%
£250,000 - £1 million	100%	96%	51%	51%
£1 million and greater	100%	99%	76%	76%

We then considered the results for the individual criteria that make up the benchmark for each document.

Trustees' annual report

As previously discussed, all of the charities in the two largest income samples provided a trustees' annual report. However, one charity in our lowest income sample did not file a narrative report and another 9% provided notes of an annual general meeting or a Chair's report instead of a trustees' annual report, even after we gave the trustees the opportunity to make good an incomplete submission.

External scrutiny report

Once again, there was a high level of compliance from the charities in the two largest income samples. The exceptions included one charity that did not file a scrutiny report and another that filed an independent examination report when an audit was required. Four charities in our lowest income sample also did not file a scrutiny report, even after we gave the trustees the opportunity to make good an incomplete submission. The main failing, however, was that the external scrutiny report did not have the correct wording, such as referring to the repealed Charities Act 1993.

The accounts

There were two main reasons why charities in the two largest income samples failed to meet the benchmark:

- incomplete reporting of related party transactions. 34% of the accounts in the £250,000 - £1 million income sample and 14% of the accounts in the over £1 million income sample did not meet this requirement. We have produced a separate report in which our findings are discussed in more detail. For further information, see Accounts monitoring review: reporting of related party transactions in charity accounts
- not providing a separate summary income and expenditure account, or not stating that it was included in the Statement of Financial Activities (SOFA). This criteria applies only to charitable companies, but approximately 70% of the charities in each of the two larger income samples are companies. 21% of the companies in the £250,000 - £1 million income sample and 12% of the accounts in the over £1 million income sample did not meet this requirement

The charities in our lowest income sample performed even more poorly on these criteria. However, the criteria are less relevant because 34 of the charities opted to prepare receipts and payments accounts, where there is no requirement to disclose related party transactions, and only 30 of the charities in this sample were companies.

Whilst all of the charities in this sample filed accounts, more than a quarter of them (28%) did not meet a basic integrity standard, with incorrectly labelled or missing statements and without any information on the types of funds held.

The results of our assessments of each sample against all of the benchmark criteria are provided in the Appendix.

The relative performance of auditors and independent examiners

The section of our samples with the highest percentage of charities meeting the benchmark is those with an income over £1 million, all of which must be audited. The audited charities in the other two samples did not reach the same standard, but a higher percentage met the benchmark than the accounts that had been independently examined.

Charity income/ Type of scrutiny	% of accounts meeting the external scrutiny benchmark	
	Independent examination	Audit
£25,000 - £250,000	38% (of 92 charities)	50% (of 4 charities)
£250,000 - £1 million	48% (of 67 charities)	59% (of 32 charities)
£1 million and greater	0% (of 1 charity)	77% (of 95 charities)

The trustees of charities with incomes less than £250,000 who opt for independent examination are not required to appoint a person who is a member of a recognised accountancy body. However, the trustees of 70 of the 92 charities in our sample that opted for independent examination appointed qualified examiners. The qualified examiners performed significantly better than the unqualified examiners, with 44% of the accounts that they reviewed meeting the benchmark, compared with only 18% for the unqualified examiners.

What action are we taking?

We are working with the accountancy profession

For each of the accounts in our samples, we recorded the accountancy body, if any, that the charity's auditor or independent examiner stated they were a member of. We then checked the membership of each auditor and examiner using the accountancy bodies' online member search tools. Firms or individuals regulated by the Institute of Chartered Accountants in England and Wales (ICAEW) and the Association of Chartered Certified Accountants (ACCA) issued the vast majority of audit or independent examination reports.

Body/ report	Number of external scrutiny reports	Number of accounts not meeting criteria
ICAEW	203	69
ACCA	47	30
Other Charities Act 2011 listed body	18	12
No qualification stated	23	19
No scrutiny report filed	5	5
Total	296	135

We are working with ICAEW and ACCA to improve their members' awareness of charity reporting and accounting requirements, and to identify the necessary improvements to the learning and resources available to their students and members. Both ICAEW and ACCA have provided statements to this report.

As part of our collaborative approach to improvement, we are providing details to these professional bodies of their members who had audited or examined sets of accounts that did not meet our benchmark. We intend to initiate similar arrangements with the other bodies listed in the Charities Act 2011.

We have updated our guidance for trustees on independent examination

The trustees of most charities can opt for an independent examination of their charity's accounts. We have updated our guidance for trustees on independent examination. For further information, see Independent examination of charity accounts: guidance for trustees (CC31). The guidance gives trustees the information they need to:

- check whether their charity can have its accounts independently examined instead of audited
- appoint a suitable person to carry out the independent examination, and
- prepare for the independent examination

We have provided guidance to the trustees of individual charities

We have contacted the trustees of the 135 charities that filed trustees' annual reports, external scrutiny reports and/or accounts that failed our benchmark. We have provided guidance to help them improve the quality of their future trustees' annual reports and accounts. We have also required the trustees of 10 of these charities to address additional specific concerns that we identified:

- one charity that did not file any form of trustees' annual report
- five charities that did not file any form of external scrutiny report
- three charities that did not comply with one of the accounting or external scrutiny thresholds, including one charity that had appointed an examiner who did not hold the required professional qualifications
- one charity that had appointed one of the trustees as its independent examiner, in clear breach of both the trustees' and the examiner's duty to ensure that the person carrying out the examination is independent of the charity

What are the lessons for other charities?

Arranging for your charity's accounts to be subject to external scrutiny, either an audit or independent examination, is an important part of providing assurance to the trustees and others with an interest in the charity's activities about the content and accuracy of those accounts. However, our review has highlighted that the trustees of a significant number of charities have appointed auditors or examiners whose work does not meet our external scrutiny benchmark.

The trustees of most charities can opt for an independent examination. We have updated our guidance about independent examination to help trustees fulfil their legal duty to appoint 'an independent person who is reasonably believed by the trustees to have the requisite ability and practical experience to carry out a competent examination of the accounts'. For further information, see Independent examination of charity accounts: trustees (CC31).

The trustees may delegate aspects of accounts preparation to charity staff or their independent examiner or auditor. However, the trustees remain responsible for approving those accounts and for preparing the trustees' annual report. You may find it helpful to use our accounts packs, since they provide a structure for producing a trustees' annual report and accounts that meet our requirements.

You can find the accounts packs and more information about your responsibilities for preparing the trustees' annual report and accounts on GOV.UK.

Appendix: the results of our assessments of each sample against each of the benchmark criteria

Criteria/ sample	Income: £25,000 - £250,000 (100 charities)	Income: £250,000 - £1 million (100 charities)	Income: Over £1 million (96 charities)
Trustees' annual report			
Trustees' annual report or Directors' report	90%	100%	100%
External scrutiny report			
Audit or examination report	89%	99%	100%
Audit report if required by income and assets	n/a	100% (of 7 charities)	99%
Refers to Charities Act 2011/ Companies Act 2006 as required	76%	96%	100%
Accounts			
A basic integrity check that applies to both forms of accounts			
Receipts and payments account or SOFA	81%	97%	100%
Statement of assets and liabilities or balance sheet	85%	99%	100%
Statements internally consistent	93%	100%	100%
Statements add up	92%	100%	100%
Charitable funds accounted for	79%	97%	100%
Additional criteria that apply only to accruals (SORP) accounts			
Accruals if required by income or a company	100% (of 30 charities)	99%	100%
Prepared under current Charities SORP	73% (of 66 charities)	90%	98%
Related party transactions disclosed	55% (of 66 charities)	66%	86%
Further criteria that apply to some accruals (SORP accounts)			
Income and expenditure account included if a company	50% (of 30 charities)	79% (of 68 charities)	88% (of 69 charities)
Cash flow statement included if required by income	n/a	71% (of 38 charities)	95%
Consolidated accounts prepared if applies and required by income	n/a	n/a	100% (of 44 charities)

Annex: ICAEW and ACCA statements on the Charity Commission report

ICAEW

While ICAEW auditors and independent examiners fared better than others, the number of accounts not meeting the external scrutiny benchmark is still disappointing. We have asked the Charity Commission for more details and we have agreed a plan with them to improve the quality of work of ICAEW members in this important area. The results of the review also send a clear message to Trustees in terms of the choices they make when they appoint auditors and independent examiners, particularly where unqualified advisors are under consideration.

ACCA

We welcome this report and for the opportunity to include this short statement.

This is an important accounting monitoring review of Auditors' and independent examiners' compliance with their responsibilities from the Charity Commission, with findings on which ACCA will be taking action.

We believe this action is necessary because of our Royal Charter and our work to protect the public interest, promote responsible and ethical business and support economic performance. It's vital that the charity sector delivers timely and trustworthy information to the Charity Commission, as accountancy professionals working in the charity sector act in the public interest.

The accountancy profession is often the first line of defence for important financial and regulatory issues identifying significant failings in accounts being reviewed. There is a responsibility on the profession to uphold the highest of standards, regardless of the sector.

As a result of this review and its findings, we are working closely with the Commission and our members to ensure the value of audit and all reporting for the charity sector remains a top priority. It is important for anyone involved in the charity sector, especially trustees, auditors, independent examiners, internal auditors and professional bodies, to take appropriate action.

CHARITY COMMISSION
FOR ENGLAND AND WALES

Accounts Monitoring Review

Reserves policies: demonstrating and building resilience

Why are we reviewing charities' reserves policies?

Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes. We are reviewing reserves policies because setting and monitoring a policy is an important part of maintaining a charity's financial resilience. This is because establishing a reserves policy requires an understanding of both the financial risks faced by the charity and of the funds that the trustees can draw on in case of need. However, reviews of reserves reporting by the largest charities have identified a lack of transparency about reserves held and the basis of charities' calculations. For example, see the Civil Society article largest charities overstating free reserves by almost 20 per cent.

All registered charities must explain their policy on reserves in their trustees' annual report, stating the level of reserves held and why they are held. Charities with incomes over £500,000 should expand their review of the charity's reserves, for example by comparing the level of reserves with the charity's policy and explaining what steps are being taken to bring them into line with it, where relevant.

How did we carry out the review?

In January 2018, we selected a random sample of 106 sets of accounts of charities with an income of over £500,000, for period ends in the year ended 31 December 2016. There are just over 11,500 charities of this size on our register and they account for approximately 90% of the sector's income.

We reviewed each trustees' annual report and accounts to assess whether:

- the charity had explained its reserves policy, as required
- the charity's stated level of reserves was correct, based on our guidance

The sample size means that our findings are statistically representative of the accounts filed with us for this period by this group of charities. However, as with all samples, there is a margin of error.

What did we find?

Whether the charities had explained their reserves policies

Nearly all, 97%, of charities in our sample included at least a reference to their reserves policy in their trustees' annual report. However, more than a third of the charities' explanations of their reserves policies did not provide all of the basic information required. The level of reserves held was the most common omission.

Does the trustees' annual report:	% of charities
Explain the charity's policy on reserves?	92%
State the level of reserves held?	67%
State why reserves are held?	90%
Meet all three requirements?	64%

Trustees took a wide range of approaches to their reserves policy disclosures. At one end of the range were cursory statements of one or two sentences that gave little insight into the trustees' thinking. At the other end of the range were lengthy discussions of various funds, which were difficult to grasp. The best reserves policy disclosures gave confidence that the trustees had assessed both the risks that their charity faced and the charity's ability to manage their financial impact.

Whether the charities had calculated their level of reserves accurately

We used the information in each charity's reserves policy and accounts to assess whether their stated level of reserves was accurate. Where the figures differed, we attempted to work out why.

Our guidance Charity reserves: building resilience (CC19) sets out a process for calculating the level of reserves. The starting point is the total of unrestricted funds. From this, the trustees should deduct tangible fixed assets held for charity use, such as land and buildings and programme-related investments. Fixed asset investments should not be deducted. The trustees should also deduct amounts designated for essential future spending. These deductions recognise that disposing of these assets or releasing these funds may impact on the charity's ability to deliver its aims.

Based on our calculation, less than a quarter of the charities in our sample had stated the correct figure in their trustees' annual report. This was in part because a third of the charities in our sample did not include a figure for reserves.

The reserves figure in the trustees' annual report:	% of charities
Was not stated	33%
Did not deduct fixed assets held for charity use and/ or designated funds	30%
Deducted fixed asset investments	3%
Included restricted funds	3%
Was shown as net current assets or cash held	5%
Did not appear to relate to the figures in the accounts	4%
Was calculated in accordance with our guidance	22%
Total	**100%**

The main underlying reason why the reserves figures were incorrect appears to be that many trustees believe that reserves are the same thing as total unrestricted funds. There were a few instances where an incorrect reserves figure may have been due to a pragmatic decision to leave small items out of the calculation, in particular low value fixed assets held for charity use. Conversely, the trustees of charities that do not hold fixed assets and that have not set aside designated funds will have all of their charity’s unrestricted funds available as reserves. They may therefore have stated the correct reserves figure in their trustees’ annual report even if they did not fully understand what reserves are.

Charities with an income over £500,000 are required to provide their reserves figure in their annual return. For the charities in our sample that did not state their level of reserves in their trustees’ annual reports, we used their annual return figure to gain an insight into their understanding of how to calculate reserves. Only 17% of the figures given in the annual returns were correct, indicating that the trustees of this section of our sample do not fully understand what reserves are.

Trustees that have an incomplete understanding of reserves may assume that their charity has more unrestricted funds available to draw on than is in fact the case, particularly where significant amounts of funds are tied up in buildings. This may therefore lead the trustees to make poor decisions about the charity’s finances.

In addition, all the charities in our sample are required to prepare their trustees’ annual report and accounts in accordance with the Charities Statement of Recommended Practice (SORP) (FRS 102). This requires trustees to consider whether their charity is a going concern and to identify any uncertainties as to going concern. We would expect the reserves policy and the level of reserves held to form a key part of the trustees’ assessment of going concern, alongside a review of cash balances and likely cash flows. It is therefore a significant concern that so few larger charities appear to fully understand what reserves are or disclose them correctly.

What action did we take?

With our guidance

We have updated our guidance on reserves, [Charity reserves: building resilience (CC19)], to bring it into line with the [Charities SORP (FRS 102)]. We are also considering whether a more wide ranging review of our guidance is needed.

With the Charities SORP

The Charities SORP is periodically updated to take account of changes in financial reporting requirements. The four charity regulators across the UK and Ireland will begin developing a new Charities SORP from 2019.

We will use the findings from this review to inform the Joint Chairs of the SORP-making body. We will recommend that the SORP-making body considers being more directive about how the new Charities SORP defines reserves and the information that charities are required to provide in their trustees’ annual reports and accounts.

With individual charities

We will send a copy of this report and our updated guidance to all of the charities that did not provide the required reserves policy disclosures and/or had not calculated their level of reserves in accordance with our current guidance.

Lessons for other charities

Providing a clear explanation of the reasons why reserves are needed, setting out the basis for working out the level of reserves required and stating the level of reserves held is more than just meeting a reporting requirement. The process of developing a reserves policy and then explaining it in the trustees' annual report gives confidence that the trustees have assessed both the risks that their charity faces and the charity's ability to manage their financial impact.

Our guidance, Charity reserves: building resilience (CC19), explains what reserves are and sets out the steps that trustees should follow in developing and explaining a reserves policy.

Accounts monitoring review for the SORP Committee: Are charities explaining the difference they make?

Why should trustees explain the difference that their charity makes?

Charities exist to make a difference - to the lives of those they were set up to help and to wider society. Trustees, volunteers and supporters share a passion for their charity's cause, in common with those working in the sector.

During the Covid-19 pandemic, we've seen again how vital the work of many individual charities in our society is: charities' work saves, sustains and enriches life in myriad ways. The lockdown has demonstrated the way in which charities have been relied on to provide life-saving services; whilst we have also seen small local community groups innovating and helping people, in support of a common cause.

We have also seen just how reliant charities are on the contributions people of all backgrounds make on a continuous basis. Our research has found that the public are keen to know that charities are making the impact they promise to make. People want evidence about how far their donations are going. Reassurance requires real examples, if not always hard statistics though these do help to inspire trust. Examples of lives that have been changed, equipment that has been acquired, or policies that have been implemented all help to reassure the public that charities can be trusted to fulfil their purpose (see Regulating in the public interest).

The trustees' annual report is a key means by which each charity's trustees are publicly accountable for how they have used the charity's money and other assets to carry out its mission. It is the only description of a charity's work that all registered charities must prepare and make available to the public. Charities that prepare their trustees' annual report and accounts using The Charities Statement of Recommended Practice (the SORP) are encouraged to go further and report on impact in their trustees' annual report.

Are trustees explaining the difference that their charity makes?

To find out how well charities are doing at explaining the difference they are making, we reviewed a representative sample of 102 trustees' annual reports filed with us for the 2017 financial year.

What we found leads us to believe that trustees are not taking the opportunity to show the public what their charity has achieved. As a result, the contribution that the charity is making may not be recognised and valued.

The following themes emerged from our research:

- There is a high level of awareness amongst trustees of the requirement to prepare a trustees' annual report. Nine out of ten charities (91%) filed a trustees' annual report, with a further one in twenty (5%) filing some other form of narrative report, such as a Chair's report, instead

- Most trustees' annual reports provide an explanation of both what the charity was set up to achieve, its mission, and what the trustees have done during the year to carry out that mission. Seven out of ten charities (69%) did so

- Few trustees went beyond the minimum to make explaining the impact of their charity's work an important part of the trustees' annual report. Of the seven charities (7%) that did so, six focussed on the difference the charity had made to the lives of the people the charity was set up to help. Another focussed on the charity's impact on wider society. None covered both aspects

What does explaining the difference your charity makes look like?

All charities are different and how each charity's trustees explain the difference that their charity has made will differ too. The seven charities we identified varied in their size, in their activities and in their approach to impact reporting. What they had in common was that their trustees saw explaining the difference that their charity had made as an integral part of describing the charity's activities. They had also collected the information they needed to assess the impact of those activities.

Accounts monitoring review for the SORP Committee: Reviewing the quality of smaller charity accruals accounts

Why are we reviewing the accounts of smaller charities?

One of the key conclusions of the Charities SORP Governance Review 2018/19 is that 'There is a need to offer greater simplification of financial reporting requirements for smaller charities, which comprise the vast majority of users of the SORP. A fresh focus on the reporting needs of smaller charities is required' (see Guiding the development of the Charities SORP).

The SORP defines smaller charities as those with incomes below the larger charities threshold of £500,000. Smaller charities make up more than nine of out ten (93%) of the charities on the register of charities for England and Wales. The Charity Commission's accounts monitoring reviews have consistently highlighted that the trustees of smaller charities often struggle to prepare accounts that meet basic financial reporting requirements (see Auditors' and independent examiners' compliance with their responsibilities as a recent example). Simplification of the financial reporting requirements may help to address this issue.

Whilst smaller charities make up the vast majority of the charities registered in England and Wales, more than four out of five (81%) of them may opt to prepare receipts and payments accounts. This option is available to charities registered in the three United Kingdom jurisdictions that have an income of less than £250,000, unless they are companies.

Income/ form of accounts	May prepare receipts and payments	Must prepare accruals (SORP)	Total
£0 - £25,000	93,408	10,284	103,692
£25,000 - £250,000	33,402	12,086	45,488
£250,000 - £500,000	N/A	7,299	7,299
£0 - £500,000	126,810	29,669	156,479

Since the SORP does not apply to receipts and payments accounts, it may be that the SORP's focus on meeting the reporting needs of smaller charities should be on companies and those with incomes between £250,000 and £500,000. Therefore, we have carried out research to explore:

- The extent to which smaller charities that can choose to prepare receipts and payments accounts are preparing accruals accounts
- The quality of the accruals accounts prepared by those smaller charities that chose to prepare their accounts on an accruals basis

Our research was based solely on charities registered in England and Wales.

How did we carry out the review?

We reviewed the 2017 sets of accounts filed by a random sample of 100 non-company charities with incomes between £25,000 and £250,000. We assessed our sample of accounts using the Charity Commission's benchmark of the minimum standards it expects in an external scrutiny of a charity's accounts. You can find details of the benchmark at A benchmark for the external scrutiny of charity accounts.

We did not include charities with incomes of less than £25,000 in our review because they are not required to file their trustees' annual report and accounts with the Charity Commission, unless they are charitable incorporated organisations.

We did not include companies or charities with incomes over £250,000 in our review because they do not have the option of preparing receipts and payments accounts and must follow the SORP. Also, we have recently carried out separate research on the quality of charity accounts using the same criteria that includes these charities (see Auditors' and independent examiners' compliance with their responsibilities).

What did we find?

The extent to which smaller charities that can choose to prepare receipts and payments accounts are preparing accruals accounts

It was not always clear whether the accounts were prepared on an accruals or receipts and payments basis, since we found that the headings on the statements did not necessarily reflect the content of the accounts. If the accounts contained balance sheet items, such as fixed assets, debtors or creditors, we assessed them as accruals accounts and as such required to follow the SORP. Otherwise, we assessed them as receipts and payments accounts.

With this caveat, we found that just over half of the charities (54%) in our sample had prepared accruals accounts, with the others (46%) taking the option of preparing receipts and payment accounts.

The quality of the accruals accounts prepared by those smaller charities that chose to prepare their accounts on an accruals basis

Only a quarter (26%) of the accruals accounts met the benchmark.

Nearly all (98%) of the charities provided a trustees' annual report and eight out of ten (81%) filed an external scrutiny report with the required wording. However, only a quarter (26%) met the accounts criteria. The benchmark focusses on the content of the accounts, since this reflects the scope of an audit or examination.

% of accounts meeting criteria	Trustees' annual report	External scrutiny report	Accounts	All 3 documents
Accruals (55)	98%	81%	26%	26%

Our analysis of the reasons why so many accounts failed the benchmark indicates a lack of awareness of basic charity accounting requirements amongst those who prepared (and indeed independently examined) many of the accounts. In particular, more than a fifth (22%) contained an income and expenditure account instead of the required statement of financial activities (SOFA) and a similar proportion (19%) did not specify the types of charitable funds held. Note that charitable companies are required to provide an income and expenditure account in order to comply with company law. However, this is in addition to a SOFA, not instead of it.

In addition to checking basic charity accounting requirements, the benchmark for charities of this size includes two criteria that consider the notes to the accounts. These are that the accounting policies state that the accounts have been prepared using the correct version of the SORP and that related party transactions have been fully disclosed.

Half of the charities (52%) stated that they had prepared their accounts under the Charities SORP (FRS 102), as required. Approximately half of the charities that did not had either prepared their accounts under previous versions of the SORP or did not specify which version of the SORP they had used. The other half did not state the basis on which they had prepared their accounts.

However, the main reason why only a quarter of the accruals accounts met the benchmark was the incomplete disclosure of related party transactions. Only three out of ten (30%) of the charities that attempted accruals (SORP) accounts provided all of the required information. Whilst half (50%) disclosed both trustees' remuneration and expenses, barely a third (35%) disclosed transactions with those persons and entities closely connected to the charity or its trustees, referred to as related parties.

The lack of disclosure may be because many practitioners have not picked up on a change from the previous SORP, Charities SORP 2005. This required a statement that there had been no trustees' remuneration or expenses where this was the case. Whilst both of these requirements were carried over into Charities SORP (FRS 102), this also requires a similar statement where there had been no related party transactions in the reporting period. Note that this change was not highlighted in Help-sheet 2: 'What's changed?'.

The results of our assessments of each sample against all of the benchmark criteria are provided in the Appendix.

Smaller charities are encouraged, but not required, to follow the format of the SOFA set out in the SORP. This therefore does not form part of the benchmark. As part of our research, we also recorded whether the charities that had prepared accruals accounts had used the SORP's SOFA format. We found that nearly three quarters (74%) had based the format of their SOFA on that in Charities SORP (FRS 102), or one of its predecessors. Only one of the other quarter (26%) of charities had presented a SOFA. The others had provided income and expenditure accounts or, in a couple of instances, labelled them as receipts and payments accounts.

What are our conclusions?

There are two main conclusions to be drawn from our research.

Firstly, that more than half of the smaller charities that could opt for receipts and payments accounts are choosing to prepare their accounts on an accruals basis. Therefore, the next SORP must meet the reporting needs of the smaller charities that choose to apply it, not just of those who must do so because of their size or because of company law.

Secondly, that around half of the charities that chose to prepare their accounts on an accruals basis did not appear to be aware of the current version of the SORP. Around a quarter also lacked awareness of even more basic charity accounting requirements. Simplification of the reporting requirements for smaller charities will not make a significant difference to many of them unless the knowledge and skills gaps evident in many smaller charities are addressed.

A further conclusion is that nearly all charities that presented a SOFA based its format on the SORP's. The next SORP could make the SOFA format mandatory for all charities. This would provide consistency and would also encourage trustees to be publicly accountable for how much of their expenditure is charitable.

Appendix: the results of our assessments against each of the applicable benchmark criteria

Criteria	**Accruals (54 charities)**
Trustees' annual report	
Trustees' annual report	98%
External scrutiny report	
Audit or examination report	94%
Refers to Charities Act 2011	81%
Accounts	
A basic integrity check that applies to both forms of accounts	
Receipts and payments account or SOFA	78%
Statement of assets and liabilities or balance sheet	93%
Statements internally consistent	94%
Statements add up	98%
Charitable funds accounted for	81%
Additional criteria that apply only to accruals (SORP) accounts	
Prepared under current Charities SORP	52%
Related party transactions fully disclosed	30%

Accounts Monitoring Review: Pension scheme deficits – unpublished report

Summary of SORP compliance issues arising

Methodology

From the latest sector data as at 30 September 2018, we identified 1,219 charities which reported a pension deficit in their latest submitted accounts totalling £5,830.4m. (This data is extracted from Annual Return details submitted by charities with income exceeding £500,000).

From this total, a random sample of 89 charities was selected. This sample size means that our findings are statistically representative of the sets of accounts filed with us for this period. In addition to these 89 charities, we decided to include a further 11 charities with financial and other reporting risks connected to pension schemes that were identified through our proactive work on charity accounts.

We reviewed the charities' trustees' annual reports and accounts to determine the extent to which trustees report transparently on pension deficits in their annual reports. We also considered the impact of the pension scheme deficit on the charities going concern status and the actions charities were taking to deal with their deficits.

Findings

- **FRS 102 disclosures**
  Our review did not assess the technical compliance of the accounts of charities with the disclosures required by accounting standard FRS 102. However, in general we found all the charities in the review, with the exception of the four with qualified audit opinions due to non-compliance with FRS 102, had made some effort to disclose with reference to the guidance in FRS 102.
- **Impact**
  Paragraph 1.47 Charities SORP FRS 102 states that the financial review **should** explain "the impact, if any, of a material pension liability arising from obligations to a defined benefit pension scheme or pension asset on the financial position of the charity." We found that the reporting of pension deficits in the Trustees' Annual Report ("TAR") could be improved, with 58% of charities in the random sample not explaining the impact of the pension deficit on the financial position, although in some cases that may be because the charity did not consider the pension scheme deficit to be material.
- **Risk disclosures**
  Paragraph 1.46 of the Charities SORP FRS 102 states the risk disclosures that are required to be included in the trustees' annual report. This is a **must** rather than a **should.** However, only 26% of charities in the random sample included the pension deficit as a risk and only 28% of this sample clearly explained, in our opinion, how they were handling the pension deficit in the TAR.

- **Going concern**
  A pension deficit can have a serious impact on going concern. Although trustees' annual reports and accounts did contain some disclosures, in our view, the disclosures did not always reflect the seriousness of the situation. The SORP requires that charities must either set out what the material uncertainties are (paragraph 3.38) or confirm that there are no material uncertainties as to going concern (paragraph 3.39) in the notes to the accounts. Trustees should use the consideration of going concern as an opportunity to consider the nature of any funding deficit and its implications for the charity, its activities and beneficiaries. This should facilitate better financial management of both the charity's financial situation and any impact on its future activities.
- **Multi-employer schemes**
  Currently, a number of charities are accounting for defined benefit pension schemes as defined contribution schemes as permitted by FRS 102 where a charity is a member of a multi-employer pension scheme and sufficient information is not available to report its share of pension assets and liabilities. Generally, the disclosures were in line with FRS 102 and the Charities SORP 102.

Risk reporting in charity accounts

Why are we reviewing risk reporting?

All charities will face risk of one kind or another. The trustees' process of identifying the main risks facing their charity and putting in place plans for managing those risks is an important part of effective governance and oversight of a charity. It also plays a part in maintaining the charity's sustainability. The Charities Statement of Recommended Practice (SORP) requires all larger charities, those with an income over £500,000, to explain their charity's principal risks and plans for managing them in their trustees' annual report.

What are the trustees required to disclose about risk?

Paragraph 1.46 of the SORP states that larger charities must explain:

- a description of the principal risks and uncertainties facing the charity and its subsidiary undertakings, as identified by the charity trustees, and

- a summary of their plans and strategies for managing those risks

How did we assess trustees' compliance with their reporting responsibilities?

We reviewed a random sample of the 2017 accounts submitted by 100 larger charities. This approach means that we can make statements in our findings about the population of larger charities on our register for the financial year reviewed.

We began by assessing whether the trustees had provided the disclosures required by the SORP. We then analysed the disclosures in order to produce a picture of what the trustees of larger charities see as the main risks that they face.

What did we find?

<u>Compliance with the SORP's requirements</u>

The trustees of 46 charities met the SORP's requirements in that they adequately described what they saw as the main risks facing their charity and set out their plans for managing them. The trustees of a further 7 adequately described the main risks but not their plans for addressing those risks.

18 charities did provide some form of disclosure on risk (usually a statement that the trustees had reviewed the charity's main risks and established systems to manage them) but no further detail. This may be an approach carried over from a previous SORP. The Charities SORP 2005 required this level of disclosure but that has been superseded. (This is consistent with findings in other reviews that trustees are not necessarily aware of changes to SORP.)

24 charities went a little further but did not provide adequate detail, using only generic headings to describe the risks facing their charity such as "financial " or

“operational”. Such generic terms provide little insight into the character of the risks being addressed and so do not usefully add to the reader’s understanding of specific key areas of risk faced by the charity.

The remaining 5 charities did not provide any disclosure on risk despite this being a requirement of the SORP.

In summary:

Description of disclosure	**Risks & plans**	**Risks only, No plans**	**Generic Terms**	**SORP 2005 Disclosure**	**None**
Number of charities disclosing	46	7	24	18	5

The scope of this part of the study was a presence or absence check of the disclosures made. We did not attempt to assess whether the risks identified were those we would have expected in the context of a charity’s objectives and activities. The trustees are much better placed to do this in any event. But there are examples of disclosures where the risks identified appear to be out of line with the objectives and activities e.g. the charity serves vulnerable beneficiaries but safeguarding is not identified as a principal risk to be managed.

It was unclear in some of the trustees’ annual reports whether the risks reported are those identified before mitigation or those remaining after mitigation. For example, a charity whose objects include “the provision of schools . . . and . . . ancillary or incidental educational activities and other associated activities” lists its most significant risks as pupil numbers, political change and regulatory compliance. Have the trustees simply ignored safeguarding or are the three listed risks the most significant because adequate mitigation factors are in place to reduce the significance of safeguarding risk below those mentioned?

The SORP is currently silent on whether the risks to be reported should be those identified before mitigation or after post-mitigation. The only inference is that the disclosure should identify the principal risks that were managed in the reporting period.

<u>Plans and strategies for managing the risks</u>

Only 46 charities had given detail of the steps taken to mitigate the disclosed risks.

Common steps were administrative measures such as risk registers, internal controls, management systems and insurance. Other charities disclosed specific measures for specific risks e.g. for the risk “lack of diversification in funding”, the steps taken were “specialist appointed . . funding earmarked. Diversification embedded in fundraising strategy.”

The best policy disclosures gave confidence that the trustees had assessed both the risks that their charity faced and the charity's ability to manage the financial impact of those risks in the context of their charity.

<u>The main risks highlighted by trustees</u>

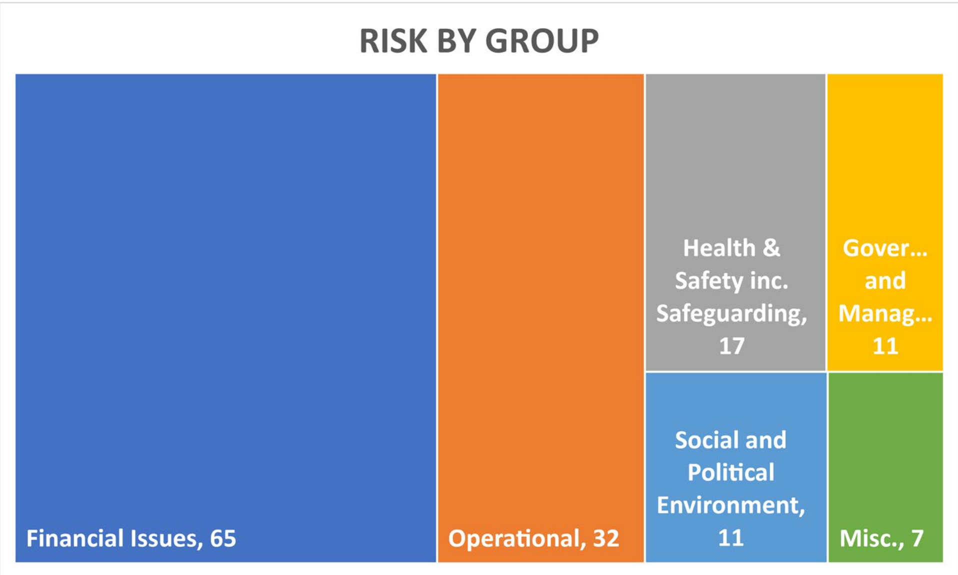
This part of the study was about using the information provided in the risk disclosures to inform our understanding of the risks that the charity sector faces.

Trustees took a wide range of approaches to their risk disclosures. Of the 53 charities disclosing adequate detail of the risks faced some reported only one main risk, others up to eight.

We initially attempted to categorise the main risks highlighted by each charity using the areas of classification in the Charity Commission guidance Charities and Risk Management, CC26, however it was clear that some specific risks disclosed by charities did not readily map over to those categories.

Some risks were clearly specific to particular charities, but others were common to broad swathes of the sector. Unsurprisingly perhaps, financial risks were the most common.

The chart below shows an analysis by broad heading:



This review has looked only at larger charities, that is, those with an income of over £500,000. These are required, by SORP, to make the disclosures detailed above.

Risks faced by smaller charities may differ in nature and severity but no disclosures are required. Nevertheless smaller charities will face risks and it is necessary for them to have effective risk management in place.

What are the lessons for other charities?

Providing a clear explanation of the main risks facing your charity and explaining your plans for managing those risks is more than just meeting a reporting requirement. Risk reporting focuses the minds of trustees on the continual process of identifying the main risks and deciding how to mitigate them. Explaining this in the trustees' annual report gives confidence to those with an interest in the charity's work that the trustees have assessed both the risks that their charity faces and their ability to manage the possible consequences. It is important to public trust and confidence in charities and the sector that trustees can demonstrate through their reporting that their charity is well governed and operating effectively.