

Charities &
Education



Independent Examination

A guide for charities



A GUIDE FOR CHARITIES INDEPENDENT EXAMINATION

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INDEPENDENT EXAMINATION

The guidance around conducting an Independent Examination (CC 32) has been re-issued following a Charity Commission consultation and now includes three additional Directions which Examiners need to follow, and which charities need to be aware of.

INTRODUCTION

Charity law requires all charities with gross annual income of more than £25,000 to have some form of external scrutiny of their financial statements each year, an Independent Examination or an Audit.

Predominantly applied to smaller charities, an Independent Examination is a less thorough form of scrutiny than an Audit. It provides less assurance in terms of the depth of work undertaken and is limited as to the matters on which the Examiner can report.

The three additional Directions for Examiners are as follows:

1. Check for any conflicts of interest that prevents the Examiner from carrying out their Independent Examination.
2. If the accounts are prepared on an accruals basis and one or more related party transaction took place the Examiner must check if these were properly disclosed in the notes to the accounts.
3. The Examiner must check whether the trustees have considered the financial circumstances of the charity at the end of the reporting period and, if the accounts are prepared on an accruals basis, check whether the trustees have made an assessment of the charity's position as a going concern when approving the accounts.

The Examiner also has a statutory duty to report matters of material significance to the Charity Commission and also has the discretion to report other relevant matters.

The new Directions must be applied for Independent Examiners reports signed on or after 1 December 2017.

Trustees therefore need to ensure that they are aware of their responsibilities around the three new areas, particularly around identifying related party transactions and considering how they assess the charity's position as a going concern.

BACKGROUND

What is an Independent Examination?

An Independent Examination involves a review of the accounting records maintained by a charity and a comparison of the year-end financial statements with those records. It also involves a review of the financial statements and the consideration of any unusual items or unexplained variances.

The Examiner also has to consider whether any matters have come to their attention as a result of the examination which should be included within their report, to ensure that a proper understanding of the financial statements is reached.

An Independent Examination is a less thorough form of scrutiny than an Audit. It provides less assurance in terms of the depth of work undertaken and is limited as to the matters on which the Examiner can report.

Who needs to have an Independent Examination?

The form of scrutiny required depends on the size of the charity and whether or not it is also registered with Companies House (i.e. is an incorporated charity). However, any specific provision in the charity's governing document overrides the statutory provisions if it demands a higher standard of scrutiny.

Broadly, an Independent Examination is required when a charity's gross income for the financial year exceeds £25,000.

If a charity's income exceeds £1million or £250,000 and it has total assets > £3.26 million then it must have an Audit. Smaller charities can also choose to have an audit in preference to an Independent Examination if they wish.

Who can be our Independent Examiner?

An Independent Examination must be carried out by a person who is independent from the charity and who has the necessary knowledge and experience of charity accounting.

If the gross annual income of the charity exceeds £250,000 then only persons who are members of one of the listed bodies can undertake the Examination.

The full list of relevant bodies is included on - *page 9*.

DETAILED GUIDANCE

In this section we consider the three new Directions and how they may impact your charity.

1. APPOINTING YOUR INDEPENDENT EXAMINER (DIRECTION 1)

Your Independent Examiner must not be influenced, or perceived to be influenced, by either:

- Close personal relationships with the trustees
- Being a major donor
- Having control or significant influence over a major funder; or
- Through day to day involvement in the administration of the charity.

The Examiner can be a member/supporter of the charity but needs to be seen to be independent of the charity. The Examiner should have the necessary ability, experience and, where required, hold a relevant accountancy qualification - *see page 9*.

2. RELATED PARTY TRANSACTIONS (DIRECTION 7)

Under this Direction the Examiner will be required to:

- Check that the trustees have considered if there were any related party transactions during the year; and
- Check that the trustees have made the disclosures required by the Statement of Recommended Practice (SORP) in the notes to the accounts.

See page 7 - for detailed guidance on related party transactions.

Trustees' are legally responsible for ensuring that decisions are made exclusively in the interests of the charity, and that any private benefit to a trustee or related party is authorised, necessary and incidental to the charity fulfilling its charitable purpose. The disclosure requirements differ with the size of the charity and therefore the type of accounts prepared - *see page 9*.

Receipts and payments accounts

There is no legal requirement when preparing receipts and payments accounts to disclose related party transactions. Where trustees have decided to include a note, the Examiner will be required to review that for reasonableness.

Accruals accounts

The SORP requires the disclosure of related party transactions (see appendix 1) within the financial statements. The Examiner must therefore ensure that the trustees have considered and identified any related party transactions, including confirming if none have taken place.

Partial, incomplete or omitted disclosures are evidence of non-compliance with the SORP, which considers these types of transactions as always being material.

Where there have been no related party transactions, trustees' expenses or trustee remuneration the accounts should include a statement to that effect.

All charities that have one or more related party transactions must disclose:

- The description of a relationship between the parties (including the interest of the related party or parties in the transaction)
- A description of the transaction(s)
- The amounts involved
- Outstanding balances with related parties at the reporting date and any provisions for doubtful debts
- Any amounts written off from such balances during the reporting period
- The terms and conditions, including any security and the nature of the consideration to be provided in settlement
- Details of any guarantees given or received
- Any other elements of the transactions which are necessary for the understanding of the accounts; and
- The SORP requires the disclosure of the name(s) of the transacting related party or parties.

The reporting charity must not state that related party transactions were made at open market value or on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.

The required disclosure may be given in total for similar transactions and type of related party except where disclosure of an individual transaction or connected transactions:

- Is necessary for an understanding of the impact of the transactions on the accounts of the charity; or
- Is required by law.

3. GOING CONCERN ASSESSMENT (DIRECTION 9)

Under this section the examiner will be required to:

- Check that the trustees have considered the financial circumstances of the charity at the end of the reporting period; and
- If the accounts are prepared on the accruals basis, check whether the Trustees have made an assessment of the going concern position when approving the accounts.

Going concern refers to the ability of a charity to meet its liabilities as they fall due.

The disclosure requirements differ with the size of the charity and therefore the type of accounts prepared.

Receipts and payments accounts

As receipts and payments accounts are a factual report of cash book transactions, no judgement is made as to whether the charity is a going concern or not. Whilst the trustees are not required to make a going concern judgement they are expected, in compiling the Statement of Assets and Liabilities, to be able to identify if the charity is able to pay bills, invoices, charges or meet other liabilities as they fall due.

The Examiner will therefore be required to consider whether, in approving the Statement of Assets and Liabilities, the trustees have made an appropriate assessment of the charity's financial circumstances as well as whether the charity may be experiencing financial difficulty either of which could impact on their Report or require reporting directly to the Charity Commission.

Accruals accounts

Accruals accounts are prepared on a going concern basis, unless an alternative basis has been used. The assessment of going concern must be made by looking ahead at least 12 months from the date the Board approve and sign the accounts. When prepared on a going concern basis, any material uncertainties about going concern must be disclosed in the notes to the accounts.

The Examiner will therefore expect to see:

- The trustees assessment of and conclusion on the going concern position; and
- The assumptions on which the Board have based that conclusion.

Documentation to support this assessment could include cash flow forecasts, income and expenditure budgetary projections and/or a minuted discussion at a Board Meeting of the financial risks and/or reserves held.

The Examiner will be required to consider whether the trustees have made an appropriate assessment of the charity's financial circumstances as well as whether the assessment is adequately documented and supported – either of which could impact on their Report or require reporting directly to the Charity Commission.

APPENDIX 1 – RELATED PARTY TRANSACTIONS

Related parties are defined as “those persons or entities that are closely connected to the reporting charity or its trustees.”

The following ‘natural persons’ are classed as related parties:

- A** Any charity trustee and custodian trustee of the charity
- B** A person who is the donor of any land to the charity (whether the gift was made on or after the establishment of the charity); and
- C** Any person who is:
 - 1. A child, a parent, grandchild, grandparent, brother or sister of any such trustee (A) or donor (B) of land
 - 2. An officer, agent or a member of the key management personnel of the charity
 - 3. The spouse or civil partner of any of the above persons (A, B, C1 and C2)
 - 4. Carrying on business in partnership with any of the above persons (A, B, C1, C2 and C3)
 - 5. A person, or a close member of that person's family, who has control or joint control over the reporting charity; or
 - 6. A person, or a ‘close member of that person's family’, who has significant influence over the reporting charity.

‘Close member of a person's family’ refers to:

- That person's children or spouse
- The children, stepchildren or illegitimate children of that person's spouse or domestic partner
- Dependents of that person; and
- That person's domestic partner who lives with them as husband or wife or in an equivalent same sex relationship.

A charity is not necessarily related to another charity simply because a particular person happens to be a trustee of both. It will only be ‘related’ if the relationship means that one charity, in furthering its charitable aims, is under the direction or control of the trustees of another charity.

The following entities are also classed as related parties if any of the following conditions apply:

- The entity and the reporting charity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)
- One entity is an associate or joint venture of the other entity (or a member of the group in which the other entity is the parent or a member)
- Both entities are joint ventures of the same third entity
- One entity is a joint venture of a third entity and the other entity is an associate of the third entity
- The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity
- An entity that is controlled or jointly controlled by a person, or two or more persons, identified in A, B or C; or
- An entity in which a person, or two or more such persons, identified in A, B or C, taken together, have a substantial interest or significant influence over the entity.

Control is presumed to exist when one or more persons identified in A, B or C, taken alone or together, hold directly or indirectly, more than half the voting power of an entity.

However, control can also exist when they directly or indirectly, control half or less than half of the voting power of an entity, if they have:

- Power over more than half of the voting rights by virtue of agreement with other investors
- The power to govern the financial and operating policies of the entity under a statute or an agreement
- The power to appoint or remove the majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body; or
- The power to cast the majority of votes at the meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body.

An individual has a substantial interest or significant influence in an entity where that person, or two or more persons identified in A, B or C, taken together, have an interest in the equity share capital of that entity of a nominal value of more than one-fifth of that share capital, or is entitled to exercise, or control the exercise or, more than one-fifth of the voting power at any general meeting of that entity.

APPENDIX 2 – INDEPENDENT EXAMINER QUALIFICATIONS

In England and Wales, for financial years ending on or after 31 March 2015, once a charity's gross income exceeds £250,000, the examiner must be a person who is a member of one of the following bodies listed in the 2011 Act, as amended by the 2015 Order. The examiner should also ensure that they are allowed by the rules of that body to undertake the role of Independent Examiner.

The listed bodies are:

- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants in Scotland
- Institute of Chartered Accountants in Ireland
- Association of Chartered Certified Accountants
- Association of Authorised Public Accountants
- Association of Accounting Technicians
- Association of International Accountants
- Chartered Institute of Management Accountants
- Institute of Chartered Secretaries and Administrators
- Chartered Institute of Public Finance and Accountancy
- Fellow of the Association of Charity Independent Examiners
- Institute of Financial Accountants
- Certified Public Accountants Association.

APPENDIX 3 – WHAT TYPE OF ACCOUNTS SHOULD MY CHARITY PREPARE?

Receipts and payments accounts

- Can be prepared for non-company charities with gross income of £250,000 or less during the financial year; and
- Consists of an account summarising all money received and paid out by the charity during the year and a statement of assets and liabilities at the year end.

Accruals accounts

- Must be prepared by non-company charities with gross income over £250,000 during the financial year and all charitable companies
- Accounts must comply with the SORP (Statement of Recommended Practice)
- Consists of a balance sheet, SoFA (Statement of Financial Activities) and explanatory notes; and
- Required to show a "true and fair" view.

A GUIDE FOR CHARITIES INDEPENDENT EXAMINATIONS

The contents of this guidance have been supplied by Whittingham Riddell LLP, Chartered Accountants. UK200Group members.

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Version 1 – November 2018