

8. The work of the independent examiner **For independent examiners**

In order to assist those providing independent examination services, a number of ‘best practice’ steps have been identified for examiners to follow in undertaking their duties.

In summary, these steps are:

Step 1: Preparation by the independent examiner

Step 2: Ensuring that the charity has prepared its accounts on the correct basis and that it is eligible for independent examination

Step 3: Keeping a record and planning the work required

Step 4: Accounting records and the comparison with the accounts

Step 5: Form and content of accounts

Step 6: Drawing conclusions and preparing a report

Each step is explained in more detail as follows:

Step 1: Preparation by the independent examiner

Independent examiners, in preparing for the review of the accounting records and annual accounts, should ensure that they have an understanding of the charity for which they are providing a service. This means that the examiner should be aware of, and understand, the objectives of the charity and the activities that it undertakes in order to further those objectives. This is necessary in order for the examiner to be satisfied that the spending of the charity is in line with the charitable purposes. Identification of any expenditure outwith the scope of the charity’s purposes may constitute a matter that should be reported by the examiner to OSCR. This will be looked at in greater depth in section 9.

For those independent examiners charging a fee and therefore deemed to be providing ‘accountancy services’, there is also a need to comply with the Proceeds of Crime Act 2002 and Money Laundering Regulations – this includes the need to hold proof of identification and address for the principal office bearers and a proportion of the charity trustees.

As preparation for the examination, the independent examiner may wish to use the following questions as a guide to whether they are ready to carry out the examination.

- Am I familiar with the accounting and reporting requirements?
- Have I read the governing document of the charity?
- Is the charity eligible for an independent examination?
- If fully accrued accounts are being prepared, am I qualified to carry out the examination?
- What practical knowledge of the charity do I have?
- Have I seen the last set of accounts?
- Have I seen the minutes of the most recent meeting of the charity trustees?
- Have I seen the minutes of any other relevant meetings of the charity trustees, including the meeting where approval was given for my appointment?
- Have I checked the OSCR register entry for the charity?

Milestone 5 –

Have I carried out all the necessary preparatory work?

Step 2: Ensuring that the charity has prepared its accounts on the correct basis and that it is eligible for independent examination

This step involves looking at a number of criteria in order for the examiner to be satisfied that the accounts of the charity are prepared on the correct basis and that independent examination is the permitted form of external scrutiny for the charity. It is also important to check if the examination must be carried out by a qualified person or not.

Therefore, there are several key elements to consider:

- If the charity has prepared receipts and payments accounts, is it eligible to do so under the 2006 Regulations?
- Is the charity a company?
- Is the charity eligible for independent examination under the 2006 Regulations?

Can the charity prepare receipts and payments accounts?

As explained in section 4.1, the 2006 Regulations set out where a charity is eligible to prepare accounts on a receipts and payments basis. This is where the gross income of the charity is less than £250,000 (£100,000 for periods starting before 1 April 2011) and the charity is not a company.

In addition, the examiner should ensure that they are provided with a copy of the most up to date governing document for the charity as it is possible that the document will contain specific provisions about the format of the accounts to be prepared. For example, there may be reference to ‘true and fair’ accounts which would require the preparation of fully accrued accounts. Receipts and payments accounts do not fall within the definition of ‘true and fair’ in this context.

Is the charity a company?

Where the charity is also a company, it is required to comply with not only charity law but also company law. This means that the charity must prepare fully accrued accounts on a 'true and fair' basis in accordance with both charity and company law. An independent examination must then be carried out by an appropriately qualified individual as explained in section 5.2.

Eligibility for independent examination

As outlined at section 4.2, it is important to ensure that the charity is eligible to have an independent examination of its accounts as opposed to an audit. This not only involves looking at the gross income and gross asset levels of the charity but also at the constitution or governing document of the charity.

Milestone 6 –

- **Are the charity's accounts prepared in the required form?**
- **Is the charity eligible for an independent examination?**

Step 3: Keeping a record and planning the work required

This step involves thinking about what processes need to be carried out and how they will be recorded. Obtaining a good understanding of the charity, its charitable objectives or purposes and the activities that it carries out to further or achieve these purposes, forms an integral part of deciding on what processes are most appropriate. It is also important for an examiner to keep a written record of their work from the planning stage through to their report. Any evidence, analysis or explanations the examiner obtains should be kept as part of this recording of their examination.

The record of work done during the examination process is for the benefit of the examiner, not OSCR. The record should focus on key factors taking account of risk. A comprehensive manual is not required – a series of bullet points, for example, may be sufficient at the planning stage and tick boxes alongside this would provide a record of completion. Key factors could include staffing and cash handling arrangements. The more complex the charity, the more factors that will need to be considered.

During the planning stage the examiner should consider any issues surrounding their independence. Any issues and consequent safeguards introduced should be clearly documented within the working papers. Any items documented as a threat to independence and any safeguards implemented should also be communicated to the trustees of the charity.

Once the examiner has a clear understanding of what the charity does and why, they should then consider the format of the accounting records held by the charity and the form of accounts prepared. This will guide the examiner in deciding on the most appropriate process to apply to the examination. For example, the processes carried out when examining a set of

receipts and payments accounts are likely to be different to those carried out in the course of an independent examination of a set of fully accrued accounts. Similarly, the processes carried out when examining a very basic set of accounting records comprising a manual cash book, bank statements, receipts and invoices will be different to those carried out when examining a charity that uses a computerised accounting package to maintain its accounting records.

A practical example may be that when examining a set of basic, manual accounting records, an examiner is likely to carry out some work to ensure that the entries made in the cash book correspond to transactions listed on the bank statements and to an invoice or receipt. Where a charity is using a computerised package to maintain the accounting records, this may be done initially on a test basis, but is unlikely to be required after that.

Milestone 7 –

- **Have I planned the work adequately?**
- **Do I know what processes are required?**
- **Do I have an adequate method of documenting my work?**

Step 4: Accounting records and comparison with the accounts

Under the 2006 Regulations, the independent examiner is required, in the report, to state whether any matter has come to their attention that gives them cause to believe that in any material respect the accounting records have not been kept in respect of the charity in accordance with the requirements of the 2005 Act and section 4 of the 2006 Regulations.

Accounting records

In order to be able to fulfil the obligations placed on the examiner by the 2006 Regulations, it is necessary for the examiner to review and consider the accounting records in some depth. The accounting records are required by the 2006 Regulations to be sufficient to show and explain the transactions of the charity and which:

- disclose the financial position of the charity at any time
- enable the charity trustees to ensure that the accounts are prepared in accordance with the 2006 Regulations.

The 2006 Regulations specify that the records shall contain:

- entries showing from day to day all sums of money received and spent by the charity and the source or application of those monies
- a record of the assets and liabilities of the charity.

Further guidance on what these requirements actually mean is provided in section 7.1.

In practice, for smaller charities the records will consist of:

- a basic cash book, either paper or electronic, written up on a regular basis. Records should be written up, where possible, as transactions occur.
- a record of assets and liabilities which might include a fixed asset register. This would detail equipment held with corresponding purchase cost and current value.
- a list of debtors and creditors – those people or organisations that owe money to the charity or are owed money by the charity – and the amounts due.

The independent examiner, in the report, is required to state whether any matter has come to their attention that gives them cause to believe that in any material respect accounting records have not been kept in accordance with the relevant requirements.

What does 'material' mean?

'Material' in this context means that the examiner is required to consider whether the overall format and content of the accounting records appears to be in line with the requirements outlined above. The objective is not to identify every single unintentional error or missing receipt. On a practical level, if the examiner were to stand back and look at the accounts, does the omission or inclusion of an error alter the overall picture that the accounts portray. If so, the item or issue is considered to be material.

If the examiner comes across a mistake, a decision has to be made as to whether the sum involved is large enough to warrant comment in the context of their duties. The key question is, does the omission or inclusion of an error alter the overall picture that the accounts portray?

In determining whether an amount is material, judgements will have to be made. Examiners familiar with materiality from a commercial point of view should note that materiality thresholds tend to be lower for charities because of the implicit trust placed on charities due to the nature of their income.

For further clarification, please refer to the Glossary of terms definition of 'material'.

Comparing the accounting records with the annual accounts

After examining the accounting records, the examiner should then consider those records in comparison with the annual accounts. The accounts must fairly reflect the underlying records and this is what the examiner should consider. For charities that have more than one type of fund for example (i.e. unrestricted, restricted and endowment funds), it is important to ensure that the transactions that relate to each fund are easily identifiable from the accounting records in order that they can be easily related to the appropriate columns within the accounts.

The examiner should compare the accounts of the charity with the charity's accounting records in sufficient detail to provide a reasonable basis on which to decide whether the accounts are in accordance with the accounting records.

The examiner needs to carry out sufficient procedures to be satisfied as to whether or not the regulatory requirements have been met in terms of the substance of the accounting records.

This does not mean, however, that the examiner has to individually check every receipt or invoice to a corresponding bank deposit or cash withdrawal for example.

There is no requirement to trace back to source documentation (such as paid invoices, remittance advices, letters from funders etc.) and verify accounting records unless concerns arise during the examination that cannot be explained.

Examples of procedures that may be carried out would be:

- reviewing bank statements, cash books or other accounting records for large or unusual items or transfers
- checking for completeness (control accounts, bank reconciliations)
- checking from books and records to the accounts (paying-in books to banking to accounting entries to accounts)
- checking back from accounts to accounting records if anything looks unusual.

Milestone 8 –

- **Are the accounting records sufficient in terms of the formal regulatory requirements? (Refer back to section 7.1 for further clarification if required.)**
- **Do the accounts fairly reflect the accounting records?**
- **Are there any material items to consider that are not adequately represented in the accounts?**

Step 5: Form and content of accounts

Statutory requirements

Under the 2006 Regulations, an independent examiner must consider whether the form and content of the accounts is in line with the statutory requirements. If they consider that the accounts do not comply in any material respect, they must state this in their report.

In practical terms, the actual work to be carried out will differ depending on whether the accounts are prepared on a receipts and payments basis or a fully accrued basis.

- For receipts and payments accounts, the examiner will need to consider section 9 and Schedules 2 and 3 of the 2006 Regulations. Independent examiners may find the Schedules to the 2006 Regulations useful as a checklist. The 2006 Regulations are available to download from the OSCR website.
- For fully accrued accounts, the examiner will need to consider section 8 of the 2006 Regulations and the SORP.

Please refer to Appendices 2 and 3 for further information regarding accounting requirements.

Any other information necessary

In considering the form and content of the accounts document and the accounting records, it is important for examiners to ask themselves if any other information should be disclosed within their report to enable a reader of the accounts to have a reasonable understanding of the accounts. This may involve consideration of any significant or unusual transactions or activities that the charity has entered into during the period and whether these are adequately reflected in the accounts.

Trustees' Annual Report

The accounts document for any Scottish charity must include a Trustees' Annual Report under the 2006 Regulations. The Trustees' Annual Report is an opportunity for the charity trustees to provide further supplementary information regarding their activities and achievements for the period. The report is particularly useful for readers who are not familiar with accounts but are still interested in understanding what the charity has achieved.

The content of the Trustees' Annual Report is specified in legislation. For receipts and payments accounts, the content is detailed within Schedule 2 of the 2006 Regulations. Charity trustees may wish to use schedule 2 as a checklist when preparing their report. Alternatively, the Receipts and Payments Workpack contains pro forma sheets for preparation of the report.

For fully accrued accounts, the content is detailed within the SORP. Charities preparing fully accrued accounts that are not subject to statutory audit (refer to figures 1 and 2 within section 4.2) should be aware that there are concessions available within the SORP which allow charity trustees to prepare a simplified Trustees' Annual Report. Please refer to Appendix 5 of the SORP for further clarification.

An independent examiner, in carrying out their work, is required to consider whether any of the information contained within the accounts is inconsistent in any material respect with the Trustees' Annual Report. In many cases, this may simply involve a review of any financial amounts stated within the Trustees' Annual Report and a comparison of this information with the financial statements. For example, the charity trustees may provide a brief financial overview of the charity for the year within their report which may include specifying the surplus or deficit for the year; an independent examiner would then check the stated surplus or deficit against the statement of receipts and payments or the statement of financial activities (fully accrued accounts) as appropriate. In other cases, it may be a slightly longer process, but this will depend on the extent of the information provided within the Trustees' Annual Report and the complexity of the financial statements.

Milestone 9 –

- **Do the accounts, including the Trustees' Annual Report, include all the information required under the 2006 Regulations?**
- **Are the accounts in the statutory format?**

Step 6: Drawing conclusions and preparing a report

Once the independent examiner has completed the necessary processes and procedures, they will need to reflect on all the evidence gathered and to consider any implications for their report.

At this stage, the examiner may have noted matters that necessitate some further discussion with the charity trustees. This may be to provide the charity trustees with an opportunity to amend the accounts before the examiner drafts his report which may, in turn, avoid a situation where an examiner may have to 'qualify' the report or make reference to any adverse findings from the examination.

The 2006 Regulations specify the content of the independent examiner's report to the charity trustees. It must include the following:

- the name and address of the independent examiner and the name of the charity concerned
- the signature of the independent examiner and details of any relevant professional qualifications or professional body of which the examiner is a member
- the date of the report and financial year in respect of which the accounts to which it relates have been prepared. The date of signing must be the same, or after, the date of signing of the Trustees' Annual Report and the financial statements by the charity trustees
- a statement that it is a report in respect of an examination carried out under section 44 (1)(c) of the 2005 Act
- a statement as to whether or not any matter has come to the attention of the examiner in connection with the examination which gives them reasonable cause to believe that in any material respect:
 - accounting records have not been kept in respect of the charity in accordance with section 44(1)(a) of the 2005 Act and section 4 of the 2006 Regulations
 - the accounts do not accord with those records
 - in the case of an examination of receipts and payments accounts, the receipts and payments account and statement of balances do not comply with section 9 of the 2006 Regulations
 - in the case of an examination of fully accrued accounts, the accounts do not comply with section 8 of the 2006 Regulations.
- a statement whether or not any matter has come to the independent examiner's attention in connection with the examination to which, in the independent examiner's opinion, attention should be drawn in the report in order to enable a proper understanding of the accounts to be reached

- a statement as to any of the following matters that have become apparent to the examiner during the course of the examination:
 - there has been any material expenditure or action which appears not to be in accordance with the purposes of the charity
 - any information or explanation to which they are entitled under section 13 of the 2006 Regulations has not been afforded to them
 - whether any information contained in the accounts is inconsistent in any material respect with any report of the charity trustees prepared under section 44(1)(b) of the 2005 Act in respect of the financial year in question.

The final step in the independent examination process is for the examiner to stand back and be objective about the accounts and the work done to date. They must consider whether any issues have been identified and whether the accounts actually make sense in light of what they know about the charity and by comparing the financial information with the Trustees' Annual Report.

They must ensure that they have identified all the unusual items or disclosures in the accounts. The examiner may need to seek explanations from the charity trustees for any issues that have not been resolved. The examiner should ensure that their own record of preparation, work done, explanations received and checks made is complete.

The examiner needs to:

- consider if the accounts look as they would expect from all the information they have gathered – do they make sense?
- check any large or unusual items that appear in the accounts or the accounting records.

The examiner will need to draw on their experience and exercise judgement as to what is 'unusual' for each charity.

Where no material issues have been identified and the examiner is satisfied with the results of the processes they have carried out, the reporting will be quite simple as there are no particular matters for the examiner to highlight to the reader of the accounts.

However, where issues have been noted with the format or content of the accounts or the accounting records etc, then it will be necessary for the examiner to consider the implications for their report. This means that the examiner will need to weigh up the issues identified and to assess whether or not these indicate that in any material respect the accounting records **have not been** maintained in line with statutory requirements, the accounts **do not agree** to those records or there are any other issues in relation to matters on which they are required to report. The examiner, as much as possible, needs to stand back and consider whether the accounts fairly and adequately represent what has happened in the charity in the financial period under review.

It is recognised that the drafting of the report in line with the regulatory requirements can sometimes be difficult for an examiner. In order to assist examiners, several example reports have been provided in Appendix 2 of this guidance, covering a variety of different situations.

In most cases, the preparation of the independent examiner's report for inclusion in the accounts document will be the culmination of the examiner's work. However, in the next section, the continuing reporting duties of the independent examiner to OSCR are explained.

It is worth noting here that it is the responsibility of the charity trustees to submit the accounts to OSCR along with the Annual Return Form.

Milestone 10

- **Have I considered the findings of my work?**
- **Are there any implications for my report?**
- **Have I prepared my report in line with the requirements of the 2006 Regulations?**