

Reviewing Charity Accounts: Random Sampling



Executive Summary

As part of OSCR's work to monitor compliance with accounting requirements, we have undertaken a review of the accounts submitted by 90 charities selected at random. Our aim was to better understand the areas where improvement is required and additional support for charities may be needed.

The charities selected for review are representative of the full population of Scottish charities in terms of the proportion of charities which fall within each income grouping. The key findings reflect issues which we see in our other accounts compliance work.

Our key findings were:

Trustees' Annual Report

A number of charities failed to include a Trustees' Annual Report or the report was deficient in comparison to the legal requirements.

External scrutiny

Some charity trustees are failing to ensure that the accounts are subject to the appropriate external scrutiny.

It is a legal requirement that all charity accounts are subjected to external scrutiny. This allows the users of the accounts to have confidence that there has been an appropriate independent review of the financial information.

Comparative information

Prior year information was missing from a number of sets of accounts, either completely or for some of the information in the accounts.

Notes to the accounts

A number of sets of accounts were missing the required notes to accompany the financial statements. Notes are required for both fully accrued and receipts and payments accounts. They are important as they supplement the information in the financial statements and aid a user's understanding of key factors in the accounts.

We have produced this report to inform the public of our findings and to highlight the key issues that have emerged. In sharing these key issues it is our expectation that charities will be able to learn from them and improve their own annual report and accounts. This report is part of our wider monitoring work and we intend to produce reports into the work we have been undertaking more regularly moving forward.

1. Background

All charities in Scotland are required to prepare a trustees' annual report and accounts and file these with OSCR each year. The preparation of the report and accounts is a keyway in which the charity trustees are accountable for their stewardship of the charity's funds and can be transparent about how the charity has operated during the year.

OSCR publishes the trustees' annual report and accounts of charities with income of £25,000 and more and all those constituted as Scottish Charitable Incorporated Organisations (SCIOs) on the Scottish Charity Register unless they are published elsewhere. This is designed to help those who wish to find out more about the charity have access to useful information. OSCR views the preparation of a high quality trustees' annual report and accounts as an important part of good governance of a charity.

1.1 Legislation for Charities in Scotland

The Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) is the legislation that sets out the relevant accounting requirements which charities registered with OSCR must comply with.

In terms of the 2005 Act, a charity must:-

- keep proper accounting records,
- prepare for each financial year of the charity a statement of account, including a report on its activities in the financial year,
- have the statement of accounts independently examined or audited, and
- after such examination or audit, send a copy of the statement of account to OSCR.

There are also Regulations which set out in detail the format of the accounts and external scrutiny requirements. These are the Charities Accounts (Scotland) Regulations 2006 (as amended) (the 2006 Regulations).

1.2 Charity accounts

The 2006 Regulations require charities to prepare accounts in one of two ways depending on their income, legal form and their governing document. These are:

- Receipts and payments accounts: a simple form of accounting that consists of a summary of all monies received and paid by the charity during its financial year in both cash and via the bank account, along with a statement of balances at the year end.
- Fully accrued accounts: accounts prepared using the accruals basis allocate the costs or income of a particular activity according to when the liability is incurred, or when there is entitlement or certainty about income. This is not necessarily the date on which money is received or paid out. Fully accrued accounts must be prepared in accordance with the methods and principles of the Accounting and Reporting by Charities: Statement of Recommended Practice (the SORP). Copies of the SORP can be downloaded from www.charitiessorp.org.

To help charities to get it right, we have produced guidance about charity accounting and reporting requirements: [A Guide to Charity Accounts](#).

1.3 External scrutiny of charity accounts

The 2006 Regulations require all charities registered in Scotland to have their accounts checked by someone who is independent of the charity. This is called external scrutiny. There are two types of external scrutiny:

- Independent examination: an independent examination looks at a charity's accounting records and annual accounts and considers whether the accounts are a fair reflection of the underlying records.
- Audit: this is a more comprehensive examination of a charity's accounts and accounting records which must be carried out by a Registered Auditor. The auditor must carry out such investigations as are necessary to enable them to form an opinion on the charity's accounts.

2. Monitoring by OSCR

Section 1(5)(c) of the 2005 Act states that one of OSCR's general functions is 'to encourage, facilitate and monitor compliance by charities with the provisions of the 2005 Act'. OSCR must encourage and help charities to comply with the law, and check that they do so.

In order to monitor compliance with the accounting requirements we do a basic check of the information we receive to make sure there are no obvious mistakes. We don't do a full check of every set of reports and accounts submitted. However, we do detailed checks throughout the year of some charities reports and accounts.

We undertake accounts compliance checks of a proportion of all charities submitting accounts to us for the first time. This lets us understand if charities are getting it right and to provide them with guidance at an early stage.

We also review the accounts of any charities where we identify a need to take a closer look at their accounts. This can happen for a number of reasons including:

- where we have noticed a deficiency in a set of accounts and we want to make sure it is corrected in the following submission
- where we have an inquiry into a charity

To supplement these checks we also undertake thematic reviews of groups of charities which allows us to look at areas where we have identified potential risks.

To ensure that all charities have a chance of being selected for a review of their accounts, we also undertake random sampling to supplement our other work.

3. Random Accounts Sampling

We have now completed three sets of random sampling of accounts work and we are sharing our findings to help the sector understand a bit more about the work we do, and to highlight common areas where improvement is required.

3.1 Random Sample

Each of the three samples we have reviewed was representative of the full population of Scottish charities in terms of the proportion of charities which fall within each income grouping. This means that we have looked at more charities with income under £25,000 as they represent around 60% of the charities on our Register. We excluded all crossborder charities, registered social landlords, higher and further education charities and designated religious charities as these bodies have other regulators or oversight is exercised over these bodies in another way.

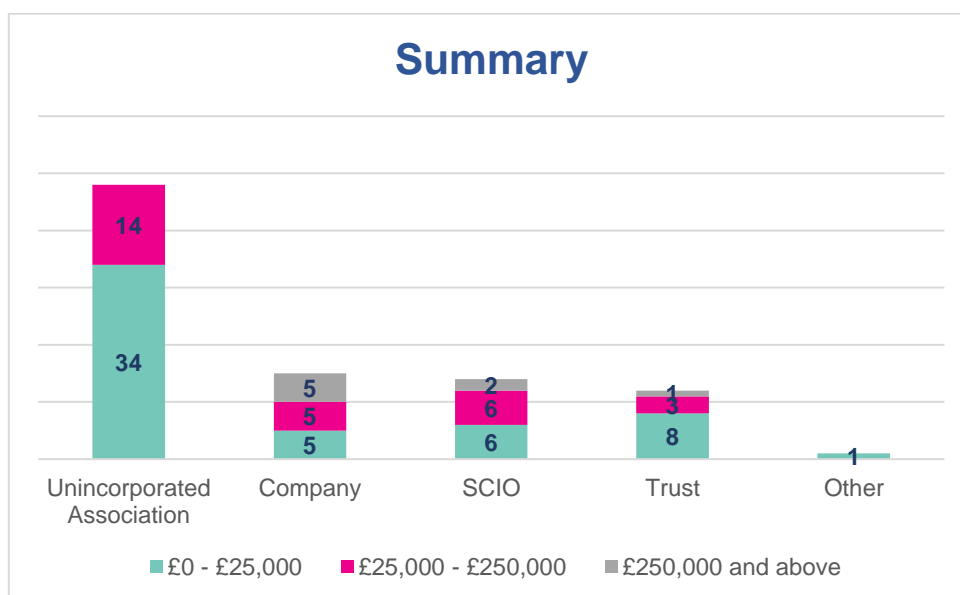
This report provides an overview of the first three samples and covers 90 charities.

The sample we looked at was as follows:

Income grouping	Number of charities
Less than £25,000	54
£25,000 - £250,000	28
More than £250,000	8

3.2 Background information about the charities and their accounts

The following chart gives some information about the relationship between the legal form and size of the charities included in the random selection.



4. What did we look at?

When looking at our random samples we wanted to look at the complete position of the charity, not just accounting compliance. We considered carefully what we can establish from a trustees' annual report and accounts alone and what other information we needed to look at.

We developed a checklist, shown at **Appendix 1**, to ensure that we considered all areas and the reviews were carried out in a consistent manner.

Below is a brief outline of the main areas of work carried out as part of the reviews.

General accounts compliance check – were the accounts prepared on the correct basis (Receipts and Payments or Fully Accrued) and were all of the required elements included. Did the accounts balance and include previous year information.

Trustees' annual report – was there a Trustees' annual report and did it include sufficient information about the charity including its trustees, its purposes and the activities undertaken to achieve those purposes.

Independent scrutiny report – had the accounts been appropriately scrutinised. Was the report worded correctly and signed off by an appropriately qualified person.

Governing document check – was the governing document fit for purpose. Were the accounts prepared in accordance with it and were there the required number of trustees.

Trustees Remuneration – where trustees were being paid we checked to see if there were any concerns around this. Did it appear the conditions set out in the 2005 Act were not being met? Was the governing document being followed?

Charity test and trading – we undertook a basic review to see if the charity was undertaking activities and that these activities were in furtherance of their purposes.

We also looked for any indicators that charities were breaching trading thresholds, or were not managing the relationship with subsidiaries appropriately.

Medium and large charities – charities with income of over £25,000 are required to answer additional questions on the annual return form and we reviewed the answers provided to these.

Detailed findings from random sampling

Of the 90 charities we reviewed there were 39 where no further action was required.

We contacted 35 charities to request further information, including details about their charitable activities or remuneration, or to request up to date copies of their governing documents. In our correspondence with these charities, we also provided guidance to 20 of them.

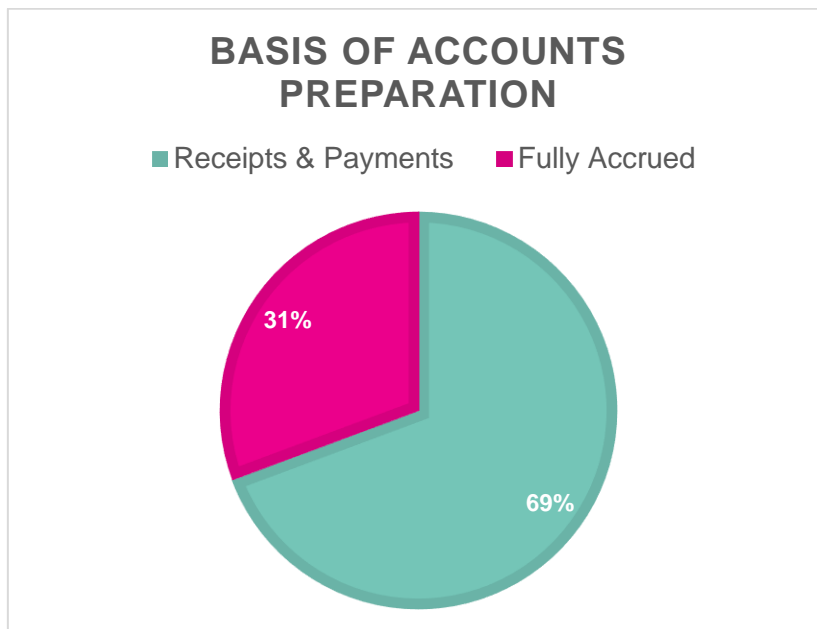
We provided guidance to a further 16 charities.

We identified 26 charities where we will undertake a review of their next submission to ensure that they have addressed the issues raised with them.

Basis of accounts preparation

In our samples, two charities did not submit a proper set of accounts. Both had no financial transactions to report and had been undertaking no, or very little, charitable activities.

Of the 88 charities that had submitted a set of accounts, 61 prepared accounts on a receipts and payments basis and 27 prepared fully accrued accounts.



5. Accounts compliance issues

5.1 Trustees Annual Report

A trustees' annual report is the narrative part of the accounts. It contains information about the charity; who the trustees are, how it is run, its activities and achievements. It also helps to explain the numbers in the accounts and helps readers understand why money has been spent in the way it has.

A trustees' annual report should contain as a minimum, the following information:

- details of who the trustees are
- objectives and activities of the charity
- details of the structure, governance and management of the charity
- achievements and performance of the charity
- financial review
- future plans

Our website has more information with [Guidance and Good Practice](#) for Trustees' Annual Reports.

Not all charities in our sample submitted a Trustees' Annual Report and where they did many did not all include the required information.

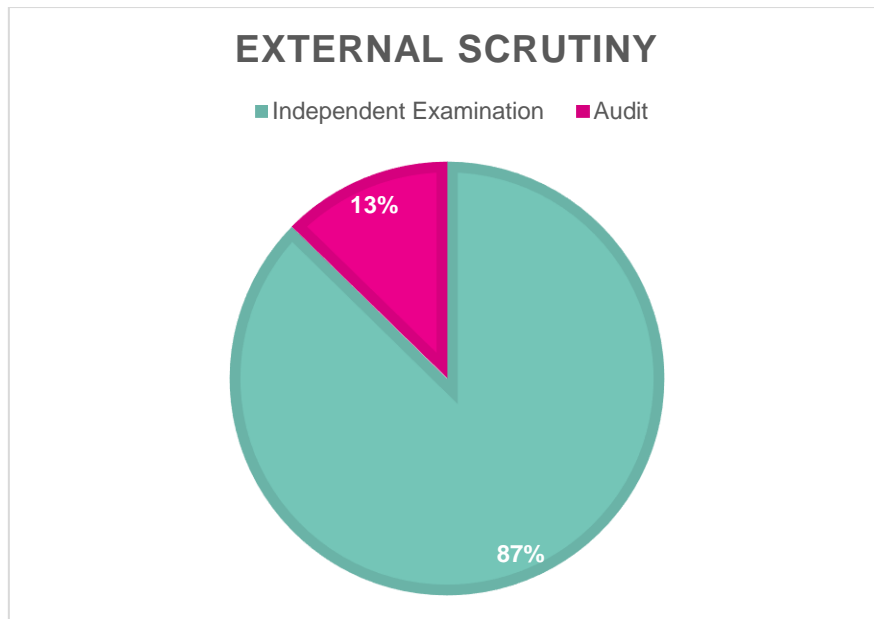
- Four charities reviewed failed to submit a Trustees' Annual Report
- Two charities submitted a Chairman's Report rather than a Trustees' Annual Report. These did not include details about the trustees, the purposes of the charity and the structure, governance and management arrangements.
- One charity only included information about the charity's trustees and contact addresses.
- Three charities failed to include information about the activities of the charity.

A lack of clarity about a charity's activities means that it is very difficult for any external reader of the accounts to really understand and appreciate what is happening within the charity. A charity must provide public benefit; it must make a positive difference for the public. In order to do this, a charity must carry out activities and these activities must be in line with its charitable purposes.

It should be clear from the accounts and particularly the Trustees' Annual Report how the charity is providing public benefit. In six cases we had to write to charities to ask them to provide more information about what activities they had been carrying out and to clarify how these activities provided public benefit.

5.2 External scrutiny

Three charities failed to submit an external scrutiny report with their accounts. 76 included an Independent Examiner's Report and 11 included an Auditor's Report.



- Three charities submitted reports which had incorrect wording or were not in the correct format.
- One independent examiner's report was signed by a firm as opposed to an individual. The independent examination must be signed by the individual who undertook the examination.
- One charity prepared fully accrued accounts but it was not clear from the report whether the Independent Examiner was qualified to undertake the examination of fully accrued accounts.
- Ten charities had opted to have their accounts independently examined, but were not eligible to do so as there was a reference in their governing document to a requirement for an audit (see governance issues below).

5.3 Comparatives


All figures in the accounts must include the corresponding amount for the previous financial year. This is called comparative information. This allows the user to make comparisons between financial years and see where there have been changes.

On seven sets of receipts and payments accounts and on one set of fully accrued accounts, no comparative information was provided.

A further three sets of receipts and payments accounts included comparative figures for some, but not all of the figures.

5.4 Receipts and Payments Accounts - Statement of Balances

The statement of balances shows the position of the charity at the year end. It must include a reconciliation between the opening and closing bank and cash balances. The surplus or deficit on receipts and payments will reconcile the cash and bank position.



If the statement of balances is missing, the figures do not add or agree with the receipts and payments account, or the opening position does not agree with last years' closing position then we will ask for resubmission.

In our samples, one charity's statement of balances did not balance and one charity did not submit a statement of balances. Both were asked to resubmit.

5.5 Receipts and Payments Accounts - form of accounts and headings used

Receipts and payments accounts are a distinct type of accounting which includes only items receipted or paid in and out of the charity's bank account. Income and expenditure are terms which are used where fully accrued accounts are prepared and will include adjustments for items not yet paid or received. We often find charities incorrectly using the headings income and expenditure where receipts and payments accounts are submitted which can be confusing for those using the accounts. We contacted five charities from our sample to advise the wrong terminology had been used.

5.6 Notes to the accounts

Notes are an important part of the accounts that are often overlooked by charities. They expand on or explain the information contained in the accounts, and will help a reader with their understanding of the accounts.

Six charities were asked to provide further information or clarity on matters that should have been disclosed in the notes to their accounts.

The issues were specifically around the disclosure of:

- Trustees' Remuneration
- Related Parties
- Grant-making activities
- Nature and purpose of funds held by the charity

6. Review of governing documents

6.1 Governing Documents

The governing document explains what a charity is set up to do, and how it should operate. It sets out the rules to be followed in running the charity. All trustees must understand the governing document, and make sure it is kept accurate and up to date.

We looked at the charity's governing document to ensure that the information provided in the accounts was in line with the governing document and to ensure that the charity was following the rules and procedures within the document itself.

6.2 External Scrutiny Requirement

10 charities had opted to have an independent examination. However, on review of their governing documents, it was found that they included a requirement for an audit to be undertaken.

Some older governing documents contain reference to a requirement for an audit as a generic term for checking the accounting records. However, the word audit in charity law means that the accounts need a full statutory audit by a registered auditor, even where the law would not require it on the basis of the charity's income or asset levels.

We advised the charities that if they wanted their accounts to be independently examined rather than audited, then the governing document must be amended to allow for this. We will follow up to ensure that either the governing document has been appropriately amended, or an audit had been undertaken in the next submission.

6.3 Number of Charity Trustees

Some governing documents set out a requirement for the minimum number of trustees for the charity. In addition to the requirements of the governing document, a Scottish Charitable Incorporated Organisation (SCIO) must have at least three trustees.

Charity trustees may be called trustees, directors, board members, or committee members, but they are the people with ultimate responsibility for the overall control and management of the charity. Without the minimum number of trustees in place, the charity will not have enough people to hold meetings and carry out effective decision-making.

Five charities did not meet the minimum number of charity trustees required by their governing document. We contacted the charities and asked them to confirm the number of charity trustees and, if they did not meet the requirement in their governing document, what steps they were taking to appoint additional trustees.

6.4 Format of Accounts

Two charities had prepared receipts and payments accounts however their governing document required a statement of account and balance sheet, which meant they were required to prepare fully accrued accounts.

We advised the charities that if they wanted to prepare their accounts on a receipts and payments basis then their governing document had to be amended to allow for this. We flagged these charities for review to ensure that either the governing document had been appropriately amended, or fully accrued accounts had been prepared.

7. Other areas identified

7.1 Annual Return

The annual return asks if a charity has children and/or vulnerable adults as beneficiaries. This was answered with 'no' by two charities who appeared to have children as beneficiaries and as such this should have been answered yes. Outwith our random sampling we have seen this question being incorrectly answered on a number of occasions. It is important that those completing the annual return ensure they understand what is being asked.

7.2 Micro-Company accounts lodged at Companies House

During the reviews it was found that two charities had lodged micro-company accounts at Companies House.

Charitable companies are not eligible to use the micro-entity regime which means that charitable companies cannot submit micro-entity accounts to OSCR or to Companies House; the same set of full accounts should be lodged with both regulators.

We have also found within our wider work that charitable companies are incorrectly submitting micro entities accounts to Companies House.

7.3 Charities no longer operating

Two of the charities selected were no longer operating and had transferred all of their assets to another body. They had failed to apply to us for consent required to wind up. They were reminded of their duties in respect of this, the recipient bodies were reviewed and the former charities were removed from the Scottish Charity Register.

A further two charities had applied to OSCR to wind up and had received consent from OSCR to do so. However, the charities had failed to provide the necessary evidence to allow them to be removed from the Register.

7.4 Charities not undertaking any activities

One charity had not undertaken any activities since they were first registered as a charity.

During our reviews, if we find that a charity does not appear to be undertaking any activities, we will contact the charity trustees for clarification about whether they have been undertaking any activities or when they expect activities to commence. In order to remain on the register, a charity must provide or intend to provide, public benefit.

8 Summary of Key Findings

Trustees' Annual Report

We found that there were a number of charities where the Trustees' Annual Report was either missing or deficient.

The Trustees' Annual Report is an opportunity for the charity to tell the story of its activities, achievements and performance in the year under review and tie this in with the financial information. A good Trustee's Annual Report can let the users of the accounts understand what activities the charity is undertaking and how it is meeting its objectives. This can encourage people to support the charity and provide funding. It also provides assurance to us as Regulator that the charity is operating appropriately.

Charity trustees should ensure that the Trustees' Annual Report contains all the required information and properly tells the story of the charity. More guidance as to the Trustees Annual Report can be found [here](#).

External scrutiny

We found that some charity trustees are failing to ensure that the accounts are subject to the appropriate external scrutiny. It is a requirement of the 2005 Act that all charity accounts are subjected to external scrutiny. This allows the users of the accounts to have confidence that there has been an appropriate independent review of the financial information.

Charity trustees and those undertaking the scrutiny must ensure that they understand not only the income thresholds when considering the appropriate level of scrutiny, but also the charity's governing document. If the governing document requires a higher level of scrutiny then this must be adhered to, or amended.

Comparative information

Prior year information was missing from a number of sets of accounts, either completely or for some of the information in the accounts.

Comparative information is required under the Charities Accounts (Scotland) Regulations 2006 (the 2006 Regulations). The inclusion of comparative information allows users of the accounts to better understand the story of the charity. They can easily see where there have been changes in income and expenditure, and better understand how the financial position has changed. The inclusion of comparative information also makes it easier to see if there are any arithmetical errors and if balances have been appropriately carried forward from one year to the next.

Notes to the accounts

A number of sets of accounts were missing the required notes to accompany the primary financial statements. Notes are required for both fully accrued and receipts and payments accounts. They are important as they supplement the information in the primary financial statements and aid a user's understanding of key factors in the accounts.

APPENDIX 1 – CHECKLIST

Random sample – Accounts review checklist

Standard information	
Charity name	
Charity number	
Legal form	
Minimum number of trustees per governing document (record number)	
Remuneration provision in governing document (record information)	
Audit requirement in governing document	
Purposes per governing document	
Income £	
Assets £	
Accounts compliance check	
<i>General</i>	
Do the accounts make reference to the correct legal form?	
Are the accounts prepared on the correct basis?	
Do the accounts include either a receipts and payments account (if receipts and payments accounts) or a statement of financial activities (if accruals accounts)	
Does the receipts and payments account or statement of financial activities provide an analysis of expenditure and income?	
Do the accounts include either a statement of assets and liabilities (if receipts and	

payments accounts) or a balance sheet (if accruals accounts)?	
Do the closing balances on each statement reconcile to each other?	
Have comparatives been required and does information from comparatives carry forward correctly?	
Is the set of accounts as a whole understandable, transparent and internally consistent?	
<i>Independent scrutiny report</i>	
Has an independent scrutiny report been submitted?	
Has an audit report been submitted if an audit was required?	
Is the wording correct?	
Is the report signed by an appropriately qualified person?	
Is the report qualified?	
<i>Trustees annual report</i>	
Has a trustees' annual report been submitted?	
Do the number of trustees equal or exceed the minimum?	
Does it appear that the trustees may be connected?	
Does the annual report explain what the charity was there to achieve (its purposes)?	
Does the explanation of its purposes agree to our understanding of its purposes from the governing document?	
Does the annual report explain what the charity had done during	

the year to carry out its purposes (its activities)?	
<i>Remuneration</i>	
Are any trustees being paid remuneration – disclosed in either accounts or annual return form?	
Is there any apparent breach of remuneration provisions in the Act or in the charity's governing document?	
Does the level of remuneration raise concern?	
Are there any other transactions with trustees and the charity?	
<i>Charity test and trading</i>	
Has the charity undertaken activities in furtherance of their purposes?	
Does a review of the accounts/TAR indicate any activities which are not in furtherance of the charity's objectives?	
Have trading thresholds in accordance with HMRC be breached?	
Are there any unusual transactions which may require further consideration?	
Are reported gift aid reclaims in line with our expectations?	
Does the charity have a trading subsidiary?	
Has the charity provided finance to the trading subsidiary?	
Are there indicators of private benefit?	
<i>Going concern</i>	
Are there any indicators of going concern issues, including details	

included in notes to the accounts or in scrutiny report?	
<i>Annual return form – medium and large</i>	
Does the charity appear to have adequate financial procedures?	
Does information provided in connection with trustee remuneration agree to that on the accounts?	
Has the charity received over 20% of its income from a person connected to the charity?	
If yes to the above do we have any concerns over this arrangement?	