Accounts Monitoring Review
The quality of charity accounts

About our accounts monitoring reports

Charities' accounts are publicly available on GOV.UK. Each year, we monitor a sample to check compliance with the Charities Statement of Recommended Practice (SORP) and to identify issues of regulatory concern. We are publishing a series of reports on our findings, which will help trustees to manage the risks that their charity faces, improve reporting standards and enhance the accountability of charities to their donors, beneficiaries and the public.

The scope and purpose of this review

This review looked at the 'the percentage of charity accounts monitored found to be of acceptable quality'. We chose this topic as one of our key performance indicators for 2014-15 and we published a report of our findings in March 2015, based on samples of accounts submitted for financial years ending in the 12 months to 31 March 2012 and 2013. We have used the same methodology to review the quality of the following year's accounts, the 12 months to 31 March 2014. We have based our assessment of 'acceptable quality' on how useful the set of accounts is to the users of those accounts rather than on strict technical compliance with the SORP.

We looked at the accounts of charities with annual incomes over £25,000. These charities are required to file the following documents with us within 10 months of their financial year end:

- their trustees' annual report (annual report)
- the report of an independent scrutiny of their accounts
- their accounts

A complete set of accounts includes all of these documents. A full explanation of our methodology and the criteria that we used is in the appendix.

How we carried out the review

In September 2015 we selected a random sample of 109 charity accounts from the register of charities, covering accounting years ending during the 12 months to 31 March 2014. This sample size means that our findings are statistically representative of the accounts filed with us for this period. However, as with all samples, the percentage of accounts of acceptable quality on the register as a whole will fall within a range either side of the sample percentage reported. We have selected the sample in the same way as we did for the previous 2 years and so we can measure whether the quality of accounts has improved over time.

What we found

The percentage of accounts that were of acceptable quality

The results of our assessment are summarised in the table.

Period ended/% of accounts assessed	2011-12	2012-13	2013-14
Accounts of acceptable quality	54%	68%	77%

It is encouraging that more than three quarters of the accounts that we reviewed this year were of acceptable quality. It is also encouraging that the inference is that the quality of accounts has again improved, although we should point out that the difference is within the range of sampling error. This year, 96% of the charities in the sample submitted all of the annual report, independent scrutiny report and the accounts in some form. Last year, the figure was 92% and the year before was 87%.

Our findings on each of the annual report, independent scrutiny report and the accounts are analysed in the following sections. We then comment on the financial risks and other regulatory issues that we identified from reviewing the accruals accounts in our samples.

The annual report

We concentrated on whether the charity's annual report had explained:

- what the charity was there to achieve (its purposes) and what it had done during the year to carry out those purposes (its activities)
- its policy on holding reserves

The results are shown in the table.

Criteria/% of accounts assessed	2011-12	2012-13	2013-14
Charities including a statement of their purposes and their activities to carry out those purposes	65%	75%	85%
Charities including a reserves policy	62%	76%	74%

We found that 90% of the charities met at least one of the annual report criteria this year. Virtually all of the charities that prepared an annual report met at least one of our criteria and most covered both. However, as in previous years, there were several poor quality submissions. 2% of charities did not file any form of report and a further 5% provided notes of their annual general meeting/ a chairperson's statement/ a treasurer's report. All of the annual reports that did not meet at least one of our criteria also failed the overall assessment of accounts quality. A further 2% of charities that had included a reserves policy still failed the overall assessment because of a lack of transparency about their activities.

The independent scrutiny report

We were concerned with whether the charity had submitted either:

- an audit report, required when the charity's income was over £500,000 (or over £250,000 and it had total assets over £3,260,000)
- an audit report or an independent examination report, if an audit was not required

The results are shown in the table.

Criteria/% of accounts assessed	2011-12	2012-13	2013-14
Charities requiring an audit that included an audit report	100%	100%	95%
Charities requiring an independent examination that included either an audit report or an independent examination report	78%	81%	89%

We found that the accounts of 90% of the charities had received the required level of independent scrutiny. 20% of the charities in the sample required an audit based on their size and a further 7% of charities also submitted an audit report. Again, as in previous years, there were several poor quality submissions. 2% of charities did not file any form of independent scrutiny report and a further 7% provided either an accountant's report or some form of scrutiny report that did not use the wording required by the Charities (Accounts and Reports) Regulations 2008. All of these charities failed to meet the independent scrutiny requirements and also failed the overall assessment of accounts quality.

Two of the audit reports were qualified. One qualification was because of insufficient evidence for the valuation of work in progress in the previous year's accounts. The other was because of a failure to comply with the accounting and disclosure requirements for heritage assets. We assessed the latter charity as failing to produce accounts of acceptable quality because it had chosen not to comply with the SORP.

The accounts

We checked firstly whether the charity had prepared either:

- accruals accounts, required when the charity's income was over £250,000 and for all charitable companies
- accruals or receipts and payments accounts, if accruals accounts were not required

We found that all of the charities that were required to prepare accruals accounts had done so. Half of the charities were required to prepare accruals accounts and more than half of the other charities also submitted accruals accounts.

We then assessed whether each set of accounts met a basic integrity standard. This was that the accounts contained both of the prime statements, the statement of financial activities (SOFA) and balance sheet (if accruals accounts) or receipts and payments account and statement of assets and liabilities (if receipts and payments accounts), and that their closing balances agreed with, or reconciled to, each other.

The results of the basic accounts integrity check are shown in the table.

Criteria/% of accounts assessed	2011-12	2012-13	2013-14
Accruals accounts that met the basic integrity standard	92%	99%	94%
Receipts and payments accounts that met the basic integrity standard	81%	81%	88%

We found that 93% of the charities had submitted accounts that met the basic integrity standard. All of the charities had filed accounts and all except one set of accounts included both of the required statements. The accounts of the 7% of charities that failed to meet the standard were internally inconsistent. All of the charities that failed the integrity standard also failed the overall assessment of accounts quality.

Financial and regulatory risks

This part of our review used the additional information provided in the accruals accounts to identify any potential financial or other regulatory concerns. We also considered the 2 audit reports and one independent examiner's report that included an emphasis of matter paragraph about or related to the charity's going concern. Where these were highlighted, we then considered whether the annual report explained how the charity was dealing with the issue. The risk indicators that we measured and our findings are summarised in the table.

Risk indicator/number and % of accounts assessed	% triggering indicator	% explained in annual report
Low charitable expenditure	8%	33%
High fundraising costs	3%	33%
Solvency issues	11%	67%
Pension scheme deficits	6%	83%
Restricted funds used for unrestricted purposes	0%	n/a
Significant loans made by or to the charity	11%	67%

We found that, overall, most annual reports did cover the issue(s) identified. The main reason why this was not the case for the indicators based on the SOFA was that the charities concerned appear to have failed to allocate their costs accurately. Major classification errors in the SOFA or a failure to properly discuss in the annual report what appeared to be significant financial risks resulted in 2% of charities failing the overall assessment of accounts quality.

Other regulatory concerns

In addition to the financial risk indicators, we also used the disclosure notes in the accounts to consider other areas of potential regulatory risk. We particularly focussed on whether transactions involving trustees indicated that there may be conflicts of interest or personal benefit.

We found that 74% of the accruals accounts had included a note on trustees' remuneration, as required by the SORP. But this means that a quarter had not: the SORP requires a nil disclosure if no remuneration was paid. Four charities disclosed that they had paid remuneration to a trustee and 2 of them met the requirement to disclose the authority under which they had done so.

Other matters of interest

In addition to measuring accounts quality, we used our samples of charity accounts to consider other the following questions of wider regulatory interest.

- Did the annual return income and expenditure figures agree to the accounts?

  The income and expenditure figures that charities provide in their annual returns are published on GOV.UK. Ignoring trivial differences, we found that 6% of charities had provided different figures for both income and expenditure in their annual returns and a further 6% had provided different figures for one of them. One charity had not completed an annual return. Several of the other differences appeared to be the result of input error, such as entering the previous year's figures or transposing income and expenditure.

- Were accounts submitted late of poorer quality than those submitted on time?

  The late submission of annual returns and accounts by a charity is an indicator of poor governance arrangements. We found that 7% of the accounts in our samples were submitted late. Given the low number, an inter-study comparison would not be reliable.

- Was there a relationship between accounts quality and size of charity?

  As noted earlier in this report, 20% of the charities in our sample required an audit on the grounds of their income and assets. In previous years, we found that a significantly higher percentage of these charities were of acceptable quality than the smaller charities in the samples. This remains the case, with 86% of the auditable charities being of acceptable quality, although the difference is smaller this year.

What action we took

We have reviewed the most recent annual return and accounts submissions of the 25 charities that did not submit accounts of acceptable quality. Twenty-two of these charities have submitted more recent accounts and the income of 2 others is now below the threshold for submitting accounts. The remaining charity's submissions are overdue. The action that we are taking can be summarised as follows:

- no further action is required (8 charities), usually because more recent accounts have been submitted and are of acceptable quality
- providing guidance to the trustees (10 charities), where the areas for improvement are such that the guidance should enable the trustees to be able to prepare future sets of accounts to an acceptable standard
- requiring action from the trustees (7 charities), where the most recent accounts contain serious deficiencies and in most cases need to be corrected and resubmitted

Lessons for other charities

It is a statutory requirement to prepare an annual report and accounts and arrange for them to be subject to independent scrutiny, if required. It is also an opportunity for the trustees to demonstrate to the charity's supporters, potential funders and the public that they have managed its resources effectively and are meeting its objectives.

We have produced extensive guidance to assist trustees and independent examiners on the preparation and scrutiny of the annual report and accounts. This includes a pro-forma annual report and both receipts and payments and accruals accounts (SORP 2005). These provide a useful structure for preparing documents that meet the reporting requirements. It is worth highlighting that new SORPs apply to accounting periods beginning on or after 1 January 2015 and that the income audit threshold has increased to £1 million for accounting periods ending on or after 31 March 2015. The new SORPs can be downloaded from www.charitysorp.org and our other guidance can be downloaded from GOV.UK.

We also remind trustees that they are responsible for checking that the accounts and other information they submit on their annual returns is correct.

Appendix: how we carried out the review

Sample selection

We selected a random sample of charity accounts from the register of charities in September 2015. Our sample of 109 charities covered accounting years ending during the 12 months to 31 March 2014. This approach enabled us to cover complete annual return cycles and allowed sufficient time for most of the charities that had filed late to be included in the population. We selected the sample at the same time of year as the previous years'. By taking samples from successive years, we can measure whether the quality of the accounts submitted has improved over time. A random sample of 96 is sufficient for us to be confident that, if we had reviewed all of the accounts submitted to us in each year, the percentage that we assessed as being of acceptable quality would lie within 10 percentage points either side of our results.

Measuring 'acceptable quality'

The definition of what constitutes 'acceptable quality' in the context of a set of accounts is a matter of judgement. We have based our assessment on how useful the accounts are to the users of those accounts, principally funders and financial supporters, rather than on strict compliance with the SORP's requirements. Our emphasis is on whether a charity's annual report and accounts taken together demonstrate how the trustees have discharged their duty to use the charity's resources responsibly to achieve its purposes. The independent scrutiny report then gives the reader a degree of assurance over the information that the trustees have presented.

This approach reflects both The Financial Reporting Council's 'Statement of Principles for Financial Reporting: Interpretation for Public Benefit entities (June 2007) and the findings of the Ipsos MORI research report into public trust and confidence in charities (June 2014).

We used the following framework for assessing each set of accounts. Firstly, we checked whether the documents submitted met a minimum compliance standard and were complete, transparent and internally consistent. The criteria are listed in the table.

Assessment criteria: basic compliance standards

Trustees' annual report (annual report)
Has an annual report been submitted?
Does the annual report explain what the charity was there to achieve (its purposes) and what it had done during the year to carry out those purposes (its activities)?
Does the annual report explain the charity's reserves policy?
Independent scrutiny report
Has an independent scrutiny report been submitted?
Has an audit report been submitted if an audit was required?
Has the auditor or examiner used the correct wording in his/her report?
Is the independent scrutiny report unqualified?

The accounts
Have accounts been submitted?
Have accruals accounts been prepared when required?
Have the SOFA and balance sheet (if accruals accounts) or receipts and payments account and statement of assets and liabilities (receipts and payments accounts) been completed and can their closing balances be reconciled to each other?

For charities that had prepared accruals accounts, we then used the additional information that they should contain to measure whether the accounts triggered any of a range of indicators of financial risk. If this was the case, we considered whether the charity had been transparent in its annual report about how it was dealing with those risks. We also noted any other potential regulatory concerns that we identified, such as indications of trustees' conflicts of interest. The criteria are listed in the table.

Assessment criteria: financial and other regulatory risks

Financial risks
Low charitable expenditure (less than 50% of income): where SOFA analysed by activity
High fundraising costs (more than 50% of expenditure): where SOFA analysed by activity
Solvency issues (an overspend of more than 25% of income and/or net current liabilities and/or net total liabilities)
Pension scheme deficits (more than 10% of income and/or 50% of unrestricted funds and/or any multi-employer scheme not shown on the balance sheet)
Restricted funds used for unrestricted purposes (negative unrestricted funds combined with positive restricted and/or endowment funds)
Significant loans made by or to the charity (loans made more than net current assets, loans received more than 10% of income and/or 50% of unrestricted funds): where analysed in the notes
Other regularity risks
Has a statement been made of the amount of remuneration paid to a trustee or a person connected to a trustee in the notes?
If remuneration is paid to a trustee or a person connected to a trustee, is the legal authority disclosed in the notes?
Details of any other related party transactions disclosed in the notes
Details of any ex-gratia payments disclosed
Details of any material frauds disclosed

The assessment of whether a set of accounts was of acceptable quality was an overall judgement based on reading the annual report, independent scrutiny report and accounts as a whole. The results from the individual criteria informed the overall judgement. The only criteria that we decided at the outset had to be met were that all of the annual report, independent scrutiny report and accounts had been submitted in some form.