Accounts Monitoring Review

Low charitable expenditure

About the commission's 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 to enhance the accountability of charities to their donors, beneficiaries and the public.

The scope and purpose of this review

This review looked at the accounts of charities with low charitable expenditure. We chose this area because of a perceived risk that they may not be using their income to achieve their charity's aims. By law, charities must spend the income they receive within a reasonable period of time on achieving their charitable purposes. In addition, independent research by Ipsos MORI on behalf of the commission found that almost half of people cite 'ensuring a reasonable proportion of donations get to the end cause' as the most important factor affecting their trust in charities.

The SORP defines charitable expenditure as 'all the resources applied by the charity in undertaking its work to meet its charitable objectives as opposed to the costs of raising the funds to finance these activities and governance costs'. Governance costs are those associated with providing the governance framework that enables a charity to operate effectively and to be accountable to its donors and other stakeholders, such as the trustees' meetings and preparing the annual accounts.

How we carried out the review

We used the information in Part B of the annual return to identify charities that had reported expenditure on charitable activities that was less than 10% of their total income. We used 10% of income as our criteria because it produced a manageable sample size that is consistent with the purpose of the review. It is not intended to suggest that this is a benchmark for the minimum amount of charitable expenditure that is acceptable.

Part B of the annual return provides summary information from the annual accounts, including the total income and the total expenditure on charitable activities. Only charities with an income of over £500,000 are required to complete Part B and therefore our review has only considered these larger charities.

We identified 443 charities whose annual returns reported charitable expenditure that was less than 10% of their income in their most recently filed accounts. At the time of the study, most of the identified accounts were for the 2012 year end. We then selected 188 of those charities for follow up. We reviewed each charity's trustees' annual report and accounts to assess whether there was a reasonable explanation for the low level of charitable expenditure.

What we found

We found that the explanation for why these charities had reported low levels of charitable expenditure could be summarised into one of the following 4 categories.

1. There was a reasonable explanation for the low level of expenditure

57% of the charities (107) were in this category. The main explanations were:

The receipt of large 'one-off' income in the year: For new charities, this was assets received from other organisations and initial donations. For existing charities, this was legacies, grants and the sale of assets. As a result, the charity's income in that year was unusually high compared with its normal level of charitable activity.

The accumulation of reserves for a specific purpose: The most common example of this was to fund a capital project. Other charities were increasing their reserves so that they could use them to provide a regular income stream that would fund future charitable expenditure.

The purchase of assets: The main examples were the purchase of property to help deliver the charity's activities and the acquisition of items by charities whose main activity is the provision of museums and galleries. These purchases are accounted for as fixed asset additions rather than as charitable expenditure.

The inclusion of trading subsidiaries: The consolidated accounts of the charity and its subsidiaries will include the subsidiaries' trading income and expenditure, which may be significantly larger than the direct charitable income and expenditure. Trading subsidiaries should, of course, be managed with the aim of generating funds for the charity's activities.

2. The annual return had been completed incorrectly

27% of charities (50) were in this category. These charities had included all or most of their charitable expenditure in one or more of the other expenditure categories in the annual return. The accounts of this group of charities showed that they had in fact spent an average of 89% of their income on charitable activity. The annual return categories mirror those in the Statement of Financial Activities (SOFA) and the relevant entry screen highlights that the information should be taken directly from the audited accounts, so it is not clear why these mistakes have been made. Part B data is displayed on the charity's homepage on GOV.UK, so potential supporters may incorrectly conclude that the charity spends only a small part of its income on carrying out its charitable objectives.

3. The accounts understate the amount of charitable expenditure

15% of charities (28) were in this category. The accounts of these charities included significant amounts of expenditure that appeared to be charitable but had instead been included within other categories on the SOFA. To the extent that there is a common theme, these charities provided services (such as training, social care and places of worship) and had recorded charitable expenditure on those services as the cost of generating funds. Interpretation of the SORP's requirements and the allocation of costs between categories requires a degree of judgement. Nevertheless, these charities appear to have significantly understated their charitable expenditure. This may lead supporters or potential supporters to conclude that the charity has either a lower level of charitable expenditure than it does or has a poor understanding of how its costs relate to the delivery of its charitable objectives, both of which could potentially risk undermining trust in the charity or alienate potential supporters.

4. The accounts do not state the amount of charitable expenditure

2% of charities (3) were in this category. Charities are required to prepare their accounts in accordance with the SORP, unless a separate SORP exists for a particular class of charity, such as a registered social landlord or further education institution. The charities in this category should have prepared their accounts using the format required by Charities' SORP, which includes a statement of the amount of charitable expenditure. In addition, 2 of these charities submitted accounts with an independent examiner's report and one with no independent scrutiny report at all. Charities with an income over £500,000 require an audit.

What action we took

Annual return errors

Charities are responsible for ensuring that their annual returns are completed accurately. However, we have checked the next annual return submitted by the charities in this group. Twenty-seven of the charities either reported significant amounts of charitable expenditure or an income of less than £500,000, which means that they no longer complete Part B. This leaves 22 charities that have continued to report a much lower level of charitable expenditure than was shown in their accounts. The remaining charity is now in liquidation.

Accounts interpretation issues

We have reviewed the most recent accounts submitted by the charities in this group. Virtually all of the charities continue to report incomes over £500,000 and so are required to use the SOFA classification. However, only 5 charities have changed their accounts classification to show what appears to be a more appropriate level of charitable expenditure. We will provide guidance to the 23 other charities on the SORP's requirements for the classification of expenditure and ask them to consider whether their current accounting treatment is correct.

Accounts concerns

We have reviewed the most recent accounts submissions of the 3 charities that we had identified. We will require 2 of them to resubmit their most recent accounts with an audit report in one case and an independent examiner's report in the other (its income is now well below £500,000). The remaining charity is now using the correct accounts format and its income has fallen below £500,000, so the accounts no longer require an audit.

We found that a further 7 charities in the sample had also submitted independent examiner's reports. Two of these charities have had their most recent accounts audited. A further 4 have reported incomes significantly below the audit threshold since the accounts that we originally reviewed and so no longer require an audit. We will require the remaining charity to resubmit their most recent accounts with an audit report.

Next steps for the commission

The findings of this report indicate that many larger charities do not fully understand, or are failing to comply with, the reporting and accounting requirements that apply to them. We will therefore increase our work to promote our guidance in these areas, including through digital and social media campaigns, to help improve awareness and compliance.

Lessons for other charities

The findings from our review emphasise the importance of trustees having a good understanding of their charity's activities and how this is reported in their annual reports, accounts and annual returns. There are valid reasons why a charity may report low charitable expenditure in any one financial year. However, trustees should ensure that they do not lose sight of their charitable objectives and that, where appropriate, they explain in their annual report their reasons for holding income as reserves. We have published guidance on reserves on GOV.UK.