Accounts Monitoring Review

The quality of charity accounts

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 and improve reporting standards.

The scope and purpose of this review

This review looked at the 'the percentage of charity accounts monitored found to be of acceptable quality'. This is the first time that we have formally measured and reported on the quality of charity accounts. 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

We selected two random samples of charity accounts from the register of charities in September 2014, drawn from successive years. One sample of 108 charities covered accounting years ending during the 12 months to 31 March 2012. The other sample of 107 charities covered accounting years ending during the 12 months to 31 March 2013. These sample sizes mean that our findings are statistically representative of the accounts filed with us for those periods. 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 percentage reported.

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
Accounts of acceptable quality	54%	68%

Our finding that the majority of the accounts that we reviewed were of acceptable quality is encouraging. It is also encouraging that the inference is that the quality of accounts has improved over the two years (although we should point out that the difference is within the range of sampling error). Having said this, there were also some very poor submissions. In particular, 13% of the charities in the earlier sample and 8% of the charities in the later sample did not submit at least one of the annual report, independent scrutiny report and the accounts in any form.

Our findings on each of the annual report, independent scrutiny report and the accounts are analysed below. We then comment on the financial risks and other regulatory issues that we identified from reviewing the accruals accounts in our samples. To aid clarity, we have combined the results from the two samples.

The annual report

We concentrated on whether the charity 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	% of charities
Charities including a statement of both their purposes and their activities to carry out those purposes	70%
Charities including a reserves policy	69%
Charities not including at least one of a statement of both their purposes and their activities/a reserves policy	19%

We found that the majority of charities met at least one of the criteria. However, an inadequate annual report was the single most important reason for failure to meet the acceptable standard. In particular, any of the annual reports that did not meet at least one of our criteria also failed the overall assessment of accounts quality. They included 6% of charities that did not submit any form of annual report and a further 5% that submitted a chairperson's statement or notes of an annual general meeting instead of an annual report. An additional 4% of charities that had included a reserves policy still failed the overall assessment of accounts quality 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, in all cases an audit is required when the charity's income was over £500,000 (or over £250,000 and had total assets over £3,260,000)
- an independent examination report if an audit was not required

We found that all of the charities in our samples that required an audit (18%) had submitted an audit report. Another 6% also submitted audit reports. However, 7% of charities did not submit any form of independent scrutiny report and a further 9% submitted reports that did not comply with our requirements. These were either accountant's reports or what appeared to be independent examiner's reports, but with wording that did not meet the requirements of the Charities (Accounts and Reports) Regulations 2008. All but three (small) charities that submitted reports with the incorrect wording also failed the overall assessment of accounts quality.

The accounts

We checked whether:

- the charity had prepared accruals accounts when it was required to do so, because it was a charitable company or had an income over £250,000, and
- the accounts met a basic integrity standard

We found that all of the charities in our samples required to prepare accruals accounts (48%) had done so. Another 25% also submitted accruals accounts.

The basic integrity standard 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.

Number and % of accounts meeting the integrity standard	Number of accounts	% internally consistent
Accruals accounts	158	96%
Receipts and payments accounts	53	81%

Whilst virtually all of the accruals accounts met the internal consistency criteria, some of the receipts and payments accounts were poorly presented. This may be because there is no legally required format. Overall, 10% of charities did not meet the basic integrity standard. They had usually failed to complete one of the required statements, although there were also instances where the statements did not reconcile to each other. These charities included 2% that did not submit any accounts. Our follow up work found that all of them have provided accounts for more recent years, so presumably had omitted to include them in their submission for the year that we reviewed.

An additional 1% of charities that met the basic integrity standard still failed the overall assessment of accounts quality because of what appeared to be material errors in their (accruals) accounts. One charity had failed to include the value of gifts in kind in the SOFA and another had not included its freehold property in the balance sheet. The audit report on the accounts of a third charity had been qualified because of the lack of availability of accounting records for some transactions.

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. Where these were highlighted, we then considered whether the annual report explained how the charity was dealing with the issue.

Financial risk indicators based on the SOFA and balance sheet

The risk indicators that we measured and our findings are summarised in the table.

Risk indicator/number and % of accounts assessed	Number triggering indicator	% explained in annual report
Low charitable expenditure	26	38%
High fundraising costs	9	44%
Solvency issues	28	61%
Pension scheme deficits	7	71%
Restricted funds used for unrestricted purposes	3	100%
Significant loans made by or to the charity	23	70%

We found that for most of the indicators, the majority of 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 and/or a failure to properly discuss in the annual report what appeared to be significant financial risks resulted in 3% 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 70% of the accruals accounts had included a note on trustees' remuneration, as required by the SORP. 22 charities disclosed that they had paid remuneration to a trustee, but only 6 of them met the requirement to disclose the authority under which they had done so. We will be contacting two charities to obtain further information from them about transactions with their trustees.

Other matters of interest

In addition to measuring accounts quality, we used our samples of charity accounts to consider 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 13% 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. For 3% of charities, this was because they had either not submitted accounts or 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.

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 12% of the accounts in our samples were submitted late and that 42% of them were of acceptable quality. The figure for the samples as a whole was 61%.

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

In order to assess this, we split the samples into 3 bands according to their income. The results are in the table.

Income of charity/number and % of accounts assessed of acceptable quality	Number	% of acceptable quality
Audit required: more than £500k (or more than £250k and £3,260k gross assets)	38	89%
Accruals accounts required: £250k - £500k	26	65%
Less than £250k	151	53%

We infer that the quality of the accounts prepared by the largest charities was much higher than the other 2 bands. Whilst the reporting requirements for larger charities are more demanding, these charities are also more likely to have trustees, or staff, with an accounting background. In addition, an audit is a more rigorous form of scrutiny than an independent examination and therefore more likely to find, and require correction of, inadequacies in the annual report and accounts.

What action we took

We have reviewed, where available, the most recent accounts submissions of the 84 charities that did not submit accounts of acceptable quality. For 80 of these charities more recent accounts were either available or are now significantly overdue, which is a concern in itself. The action that we are taking can be summarised as follows:

- no further action is required (17 charities), usually because the most recent accounts are of acceptable quality
- providing guidance to the trustees (39 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 (24 charities), where the most recent accounts still 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 that provide a useful structure for preparing documents that meet the reporting requirements. This 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 two random samples of charity accounts from the register of charities in September 2014. One sample of 108 charities covered accounting years ending during the 12 months to 31 March 2012. The other sample of 107 charities covered accounting years ending during the 12 months to 31 March 2013. This approach enabled us to cover complete annual return cycles and allowed sufficient time for the charities that had filed late to be included in the population. 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).

To provide a consistent framework for assessing each set of accounts, we used a set of criteria drawn from the financial risk factors within the commission's developing risk framework. 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 expenditure): 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.