

## **FINANCIAL THRESHOLDS IN THE CHARITIES ACT - PROPOSALS FOR CHANGE**

**A response from the**

**ASSOCIATION OF CHARITY INDEPENDENT EXAMINERS**

**March 2008**

ACIE welcomes the opportunity to comment on the proposed changes to charity accounting thresholds and appreciated the thorough way in which the subject had been approached.

Before responding in detail to the questions set out in the consultation, ACIE has two areas of concern in respect of the proposals to raise various thresholds for smaller charities - the first is one of timing and the second refers to the Charity Commission's role as regulator.

### **1 The timing of the proposed changes**

There are three main issues for ACIE here:

- a the amount of change that is already underway;
- b the progress made in rationalising charity accounting thresholds across the UK;
- c the original intent of the proposal to review the thresholds.

Given all the changes, for example to scrutiny thresholds, which have been implemented, or are about to be, as a result of recent legislation, some charities are already in the situation of requiring three different types of scrutiny of their accounts (and therefore possibly three different scrutineers) in three successive years. This present situation is compounded by the poor degree of awareness of these changes and would be compounded further by adding to the changes.

Further, the new thresholds which are already in place or pending have not been tested. For example, the early evidence at ACIE of people applying for Fellow status with the Association, who are qualified elsewhere to carry out IE in the new income band of £250,000 to £500,000, is that the quality of their scrutiny of charity accounts is often poor - but, even so, they are eligible to carry it out. We would therefore rather have a period of time to settle this particular threshold and for work to be done with and by the relevant professional bodies to address the shortcomings of their members' work in this respect.

Secondly, a number of bodies, ACIE included, have worked and/or lobbied hard over recent years to try and bring charity accounting thresholds further into line with each other across the UK. Whilst total synchronicity has not been achieved, several key thresholds do now correspond and for UK-wide charities, this is no small benefit.

Further, the original intent of the request from the House of Lords to have the thresholds reviewed was about rationalising as many thresholds as possible, not necessarily raising them. In the context of the UK as a whole, therefore, most of these proposals contradict this intent.

The consultation document reminds us that there is due to be a five year review of the impact of the Charities Act in 2011, and ACIE would suggest that that is an ideal time at which to carry out this review - to allow time for existing thresholds to be tried and for conversations to take place with other authorities in the UK in order to continue the present practice of trying to coincide thresholds.

## **2 The Charity Commission as the regulator of small charities**

There are three issues here:

- a the increase in the number of charities taken out of any requirement to report to their regulator, the Charity Commission;
- b the lack of any regulatory scrutiny by the Commission of the vast majority of reports and accounts submitted by small charities;
- c the public expectation of what the regulator of charities should be scrutinising.

If some of the proposed raising of thresholds takes place, non-regulation, at its most basic level of submitting a report and accounts, is extended to a greater number of charities. This can be presented simply as a reduction in the bureaucratic burden for smaller charities and, whilst ACIE would dispute some of the figures used to support this case in the consultation, in general, this has to be one of the results. And it is true that reporting and accounting requirements can seem irksome to small charities. However, charities are stewards of public money in all its varieties and should therefore be prepared to account properly for that money - and in the expectation that their regulator is interested in that account.

If these proposals are not about the Commission needing to manage its workload/ resources, which we are told they are not, then they are about the choices the Commission makes about its role as regulator in respect of the resources it has. It is choosing to use a risk-based approach, which is one option, but which results in increased non-regulation of small charities.

In doing this, it fails to take into account the messages which result from such an approach, namely that the Commission, as regulator, has a general disinterest in small charities and, ultimately, in their good governance. The Commission may argue this is not the case, but how do it demonstrate this when there is little to no checking of small charities' annual submissions?

This lack of checking can make the work of advisors to, and independent examiners of, small charities difficult. They can talk about good governance, proper reporting and accounting - but there is no sanction.

Further, in the light of the recent debate about MPs' expenses, where there was a large gap between the public expectation of what should be happening and the reality, there has to be concern about what the public would expect the charities' regulator to be looking at. We suspect that the public would be surprised to learn that sums of money which can be significant in a local context and which have gone missing from a charity can trigger no response from the Commission when it is reported to them - as our members tell us happens.

This debate may at first seem somewhat irrelevant to the question of thresholds. However, leaving aside the issue of timing (as above) for a moment, ACIE would be more comfortable with agreeing to some of the proposed raising of thresholds if there was a system of regular scrutiny of what is submitted to the Commission, even if only on, say, a three-year rolling programme.

Again, if the review of any changes was postponed until the 2011 Impact Review of the Charities Act 2006, this would give the Commission time to look at how it regulates its smaller charities, based on the understanding that 'risk' to the Commission and to the sector as a whole is not simply about large sums of money - indeed, if you want to money launder via the charity sector, you use and/or set up a large number of small charities.

ACIE's response to this threshold consultation, therefore, is to propose leaving things as they are and reviewing them again as part of the 2011 Impact Review. This would contain the amount of change that charities are dealing with over the next couple of years and allow time for:

- 1 new thresholds to be tested;
- 2 discussions to take place with other regulators across the UK;
- 3 further consideration to be given to the regulation of small charities.

## RESPONSES TO SPECIFIC QUESTIONS

### Baseline thresholds

There are six thresholds which, ideally, should all be aligned - the requirement:

- 1 to register with the Charity Commission (Q19)
- 2 to submit annual accounts (Q7)
- 3 to submit a TAR (Q8)
- 4 to submit an Annual Return (Q20)
- 5 to state registered status on documents (Q15)
- 6 to be externally scrutinised (Q11)

The thresholds for all of these are currently £10,000 except for registration, which is £5,000. The easy alignment, therefore, would be to increase the threshold for compulsory registration to £10,000. However, the downside of this is that you would then preclude charities under £10,000 from the benefit of registration eg, in fundraising. Voluntary registration would therefore have to be a readily available option, which it is not at present?

It would be worth considering if it would then be possible to require those who voluntarily register also to have to meet the other requirements above, thus adding responsibilities to the benefit of registered status and giving the Commission as regulator at least basic information gathering duties for all the charities which are registered with it, with the potential for scrutiny of the same by the Commission in the future.

The proposals suggest that some of these thresholds are raised to £25,000. Given the internal logic of the above, ie, that all these thresholds should ideally be the same, it would be something of a leap to take the registration threshold from £1,000 (pre April 2007) to £25,000 in such a short space of time. This would again suggest that such a move is reviewed in 2011 as part of the Impact Review, with some reservations, even then, in the light of the earlier discussion of the Commission's role as regulator.

- 1 *Do you agree that the criteria in paragraph [1.10 above] are sensible guidelines for this review and that they should be applied in a sensible and pragmatic way as outlined in paragraph [1.12 above]?*

Yes and Yes.

- 2 *Do you think that the overall package of recommendations in this paper strikes the right balance between reducing the burden on charities and the effective regulation of charities?*

No, or rather, the consultation juxtaposes only two of the relevant elements. The proposals also impact on issues of good governance and reporting to stakeholders generally and not just to the Commission as regulator. The proposals are possibly understandable if they are only about regulation - they make the regulation manageable - and they can be justified if taking a global risk-management approach. However, trustees should be being encouraged to see reporting, both narrative and financial, as more than just an 'administrative burden'. It is a management tool and vehicle for wider communication - as relevant to the small as to the large.

3 *Do you think our overall approach goes too far?*

Yes.

*If you do, would you say that the current thresholds should be retained or do you believe there is a case for reducing them? If the latter, what thresholds would you suggest?*

Re specific thresholds, see answers to questions below.

4 *Do you think that far more radical changes are justified? If you do, what major changes would you propose? Do you think there are any general limits? For example, should routine reporting focus exclusively on large charities? If so, what thresholds would you suggest?*

No.

5 *Do the proposals have an adverse impact on any group in society? Do they have an adverse impact on a particular group of charities, or their beneficiaries?*

The proposals will have an adverse effect on small charities, especially those in the £10,000 to £25,000 income band, in terms of their general governance and specifically in respect of their fundraising capacities. This then has a knock-on effect to the communities such charities serve, which are likely to be local and very close to their beneficiaries and which can therefore sometimes be effective in ways that are not available to larger charities.

6 *Do you agree that there should be no change to the requirement for all charities to prepare accounts and make them available to the public on request?*

Yes, agreed.

7 *Registered charities with income over £10,000 must send their annual accounts to the Commission. Do you agree that this £10,000 threshold should be raised? If you do, is £25,000 the right figure?*

See 'Baseline Thresholds' above.

8 *Registered charities with income over £10,000 must send their Trustees Annual Report to the Commission. Do you agree that this £10,000 threshold should be the same as the threshold for sending accounts to the Commission? If you do, is £25,000 the right figure?*

1 Yes, it should be the same;

2 See 'Baseline Thresholds' above.

9 *All registered charities must prepare a Trustees Annual Report (TAR). Do you*

*agree that a TAR preparation threshold should be introduced to ease the burden on small charities? If you do, is £25,000 the right figure, or should the level be the same as the registration threshold (£5,000) or another figure such as £10,000?*

- 1 Implicit in this recommendation is the assumption that accounts reporting is more important than organisational and narrative reporting and that, indeed, you can understand one without the other. Whilst technically, the link between the TAR and the accounts is a SORP principle and therefore does not apply to the small charity, it is a principle which arises out of common sense, namely, that if you wish to understand the charity you need both parts of the reporting.
- 2 If we wish to encourage good governance in small charities, the requirement to marshal minimal information about the charity on an annual basis has to remain, if only as a basis for reporting to the AGM, members, beneficiaries, supporters, funders, et al.
- 3 Even if this requirement were removed as proposed, most of the charities affected would still have to meet a constitutional commitment to produce an annual report and would therefore have to amend their constitution before they could take advantage of the removal of the legal requirement.
- 4 This should therefore continue to be as at present and the same as for preparing accounts, ie, something that all charities should be expected to do.

10 *Charities with income over £100,000 must prepare accruals accounts. Do you agree that this £100,000 threshold should be increased? If you do, is £250,000 the right figure?*

We know that the usefulness of Receipts and Payments accounts to charities splits the ACIE membership 50:50 (and there is evidence that this is the case in the charity accounting world generally). This split is not simply along the lines of qualified/non-qualified accountant. We are also aware that accruals accounting can be off-putting to potential treasurers and lay independent examiners.

If this threshold is to be raised, therefore, there needs to be an awareness/ educational campaign about how to prepare R&P accounts well and guidance as to when it would be appropriate for a charity to use accruals accounts even if R&P were its legally acceptable form. Further, if this threshold is to be increased so significantly, then it would be helpful to have relevant regulations about the form and content of R&P accounts. Again, a delay until 2011 would allow such work to be undertaken.

11(i) *Do you agree that the £10,000 minimum threshold for external examination of accounts should be raised? If you do, is £25,000 the right figure?*

No - see 'Baseline Thresholds' above.

*(ii) What are your views on the minimum threshold being raised to £50,000?*

This is too high a threshold.

12 *Charities with income greater than £500,000 must have their accounts audited. Do you think this £500,000 threshold should be raised? If you do, is £1 million the right figure?*

It would be wise to leave this threshold as it is at present and look at it again as part of the five year review. There is a sizeable new body of individuals moving into Independent Examination with the raising of this threshold from £250,000 to £500,000 and it would be advisable to allow them to 'learn their trade' before raising the threshold again. At ACIE, we see some very poor examples of Independent Examination from highly qualified accountants who can already work with charities with incomes of up to £500,000. If this threshold is to be raised, therefore, then the professional bodies whose members can carry out an Independent Examination in the higher income bracket, need seriously to consider introducing some charity-specific requirement.

- 13 *Charities with income greater than £100,000 but not exceeding £500,000 must have their accounts audited if their assets are worth more than £2.8 million (before deduction of liabilities).*

*(i) Do you think the lower income trigger should be raised to £250,000 in line with the proposed increase in the threshold for preparing accruals accounts?*

It is not clear why the accruals threshold is the income trigger for audit in the case of the assets test. If there is a logic, then this threshold has to move as proposed. If there is no logical connection, then the question is what has changed about whatever the rationale was for a £100,000 trigger to warrant changing it.

*(ii) Do you agree that the asset element should be increased to £3.26 million to remain in line with the threshold for companies that are not charities?*

This probably makes sense.

- 14 *If a charity with income between £250,000 and £500,000 opts for an Independent Examination, it must appoint a Qualified Examiner. If the £500,000 income-based audit threshold is raised, should this lower threshold also be raised? If so, what would be the right figure?*

See the answer to Q12 above. Also, there is not an automatic corollary between the audit threshold and the threshold for a professionally qualified examiner. Again, there would be real benefits in taking a few years to 2011 to see how current/ pending arrangements work out, including improving the standard of non-professionally qualified examiners who could be examining charities with incomes of £250,000 to £500,000 as per the proposals.

- 15 *Registered charities with income over £10,000 must state that they are registered on certain documents. Do you agree that this £10,000 threshold should be increased? If you do, is £25,000 the right figure?*

- 1 It's difficult to see why this is not a requirement of all registered charities - it's not onerous;
- 2 See 'Baseline Thresholds' above.

- 16 *There is a £500 threshold relating to recovery of the cost of proving a charity's title to a rentcharge. do you think that this should be increased? If so, is £1,000 the right figure?*

No comment to make.

- 17 *A person may be a professional fund-raiser if his or her relevant income exceeds £5 a day or £500 a year. Do you agree that these figures should be increased? If you*

*do, are £10 a day and £1,000 a year the right figures?*

No comment to make.

- 18 *There is a qualified right to a refund in connection with broadcast appeals that applies only to donations of £50 or more. Do you agree that this minimum amount should be changed? If you do, is £100 the right figure?*

No comment to make.

- 19 *Most charities with income over £5,000 are required to register with the Commission. Do you agree that this general registration threshold should remain at £5,000? If you do not, what should it be?*

See 'Baseline Thresholds' above.

- 20 *All registered charities with income over £10,000 are required to make an Annual Return to the Commission. Do you agree that this threshold should remain at £10,000? If you do not, what should it be?*

See 'Baseline Thresholds' above.

- 21 *Do you agree that the benefits of the current Annual Return, based on the annual accounts and reports cycle, outweigh the benefits of taking a different, perhaps biennial, approach to reporting? If you do not, what approach would you suggest for the Annual Return and/or the preparation of accounts and reports by charities?*

Yes, reporting needs to be done on an annual basis.

- 22 *The 2006 Act changed the ability of charities to spend capital, transfer property and modify their powers. Do you agree that no further changes should be made to the thresholds in these areas until their effect has been assessed as part of the five year review? If you do not, what changes would you make?*

Yes, agreed.

- 23 *Do you think that any other thresholds covered by this consultation should be changed? If you do, please let us have details.*

No.

**contd ...**

## **Further information about the Association of Charity Independent Examiners**

ACIE is a membership organisation, a charitable association for individuals who carry out Independent Examination (IE). Its members range from people who carry out IE as part of their voluntary contribution to their local community (perhaps examining for a couple of small local groups), to professional accountants who act as the charity specialist in some of the major national and international accountancy firms. It includes a good number of sole traders, individuals from small financial services businesses and community accountants. At March 2008, ACIE has over 580 members, of whom 126 are accredited (Full) Members.

The response above was agreed by the Council of ACIE on behalf of the membership.

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