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Technical factsheet
Conversion from cash to accruals accounting for charities: the key considerations for charity trustees and those helping them make the switch

Most charities registered in the UK have the option to choose between preparing their annual accounts on a cash basis, often referred to as receipts and payments accounts, and on an accruals basis, sometimes referred to as 'SORP' accounts. Following the Charities Act 2009 in Ireland a similar choice is anticipated for Irish charities.

For those charities already operating on a cash basis or for new charities that have yet to make this choice understanding what is involved in preparing accruals accounts is an important consideration. This factsheet considers what is involved in preparing accruals accounts for the first time and offers advice on the key issues that trustees will have to consider in making the switch from cash to accruals accounting. The aim is to allow trustees unfamiliar with accruals accounting to have the information to make an informed decision about switching to accruals accounts.

Charities at this level are normally subject to independent examination. This factsheet includes a contribution from ACIE offering reflections from experienced independent examiners on the main issues that cause problems when changing to accruals.

There are a number of factors that may require accruals accounts to be prepared:

- The default legal position in some charity law jurisdictions is accruals accounts and so trustees of eligible charities must make an active choice to prepare their charity's accounts on a cash basis.
- The choice to prepare cash accounts only applies to smaller charities and each UK-Ireland charity law jurisdiction has its own income threshold above which accruals accounts must be prepared by law.
- Charities established as charitable companies are not allowed the option to prepare their accounts on a cash basis.
- Some charity funders may specify that accruals accounts to be prepared as a condition of funding.

- Banks and other lenders may prefer to have accruals accounts as part of their application process for a mortgage or loan.
- Government, the public sector and other organisations may require accruals accounts to be prepared as a condition of awarding a contract or providing assistance.
- A charity which is part of a federation or group of charities may be required to adhere to a uniform policy that all participating charities prepare accruals accounts.
- For many charities because accruals accounts are prepared on a 'true and fair' basis these provide a fuller and more rigorous analysis of a charity's financial circumstances than cash accounts can offer.

Cash accounts allow trustees a lot of flexibility as to how these are laid out and as to what information to include, whereas accounts prepared on an accruals basis are required to be 'true and fair' and are prepared in compliance with UK-Ireland Generally Accepted Accounting Practice (GAAP). Understanding GAAP and the Statement of Recommended Practice (SORP): Accounting and Reporting by Charities applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Ireland (FRS 102) is therefore essential. If making the switch to accruals accounts it is important to choose an examiner that is familiar with accruals accounting and the SORP.

To ensure accruals accounts are prepared in the same manner by everyone, GAAP uses specific concepts and terminology to define items in the accounts, it sets out methods and principles that must be followed, for example how items are measured and valued, and it specifies particular formats for laying out the accounts and specific matters that must be included in the explanatory notes to the accounts.

Those charities required to appoint an independent examiner or auditor are also recommended to have a conversation with them about these issues. A conversation with a qualified person will be invaluable in considering the charity's particular situation and whether to make the switch to accruals accounts.

The factsheet has the following sections:

A: A discussion of the requirement for 'true and fair' and the SORP accounting framework and its requirements

B: The key issues to consider in making the switch to accruals accounting

C: Insights for trustees and practitioners on the additional information needed when switching to accruals accounts

D: Signposts to sources of free help and assistance if preparing accruals accounts for a charity

The advice in the factsheet is supplemented by a series of annexes which provide more information about a topic. It is essential when preparing charity accounts on an accruals basis that the trustee or practitioner preparing those accounts reads the applicable section(s) of the SORP. Irish charities should also note that at the time of publication the SORP is voluntary in its application in Ireland and regulations as to the form and content of charity accounts have yet to be made.

A: ‘True and fair’ and the preparation of accruals accounts

All regulated sectors of the economy have to prepare accounts to a specific format, whether government and public bodies, for-profit companies or not-for-profit entities such as charities. Annex 1 considers the definition of income used in each charity law jurisdiction to determine which charities have a choice of cash accounts. Annex 2 sets out the legal basis as to what the SORP must be followed where accruals accounts are prepared. Annex 3 considers the external scrutiny arrangements for the UK.

The legal requirement sets out when accruals accounts are prepared by a charity and all four charity law jurisdictions require accruals accounts to be prepared on a ‘true and fair’ basis. The legal requirement puts the onus on a charity’s trustees to ensure that this is done. The regulations in each of the three UK charity law jurisdictions go even further and require adherence to the methods and principles of the charities SORP. (At the time of publication specifying adherence to the SORP remains under active consideration in the Republic of Ireland.)

To be ‘true and fair’ accruals accounts have to fulfil three things:

- adhere to the legal requirements set out in the applicable law and regulations as to the layout and content of the accounts and the notes to those accounts
- in their preparation to adhere to the applicable GAAP accounting standards and, where specified, the applicable SORP approved for issue by the Financial Reporting Council
- exercise care and judgment to ensure that the accounts do not misrepresent the financial circumstances of the charity by ensuring that all material items are included and the appropriate accounting policies are applied

The requirement for the accounts to be ‘true and fair’ therefore requires the person(s) preparing those accounts to be familiar with these three things. If the trustees do not have the necessary knowledge between them then they may need to obtain assistance from an accountant familiar with charity accounts to help them which may well be their independent examiner.

Before considering some of the practical issues though it is worth thinking about why this matters and what might happen if trustees choose to follow their own path by perhaps preparing the accounts in a hybrid way – cash plus debtors and creditors- or in a way that they are already familiar with, for example in the style of a company profit and loss account.

The implications of trustees taking a different approach when preparing accruals accounts are:

- In not following the requirements trustees are not fulfilling a legal duty and this is evidence of maladministration whether it comes about by accident or trustee decision.
- Those funders and stakeholders knowledgeable about charity accounting may draw negative conclusions about the charity which will influence their decisions about supporting or working with that charity.

- In some jurisdictions the independent examiner or auditor is under a separate legal duty to report non-compliance with the SORP to the charity regulator if they become aware of it when reviewing a charity's accounts. Also, whether reportable or not, attention may be drawn to non-adherence to the SORP in the independent examiner's report or audit opinion on the charity's accounts.
- Members of professional bodies may find that non-compliance may lead to a review of their work by their professional body and a sanction if their work is found to be below standard.

Trustees in the UK already produce a trustees' annual report and those charities small enough to have the option to choose cash accounting will not find any significant differences in working through the requirements of the SORP in module 1. It is important to read module 1 since non-compliance in aspects of the trustees' annual report constitutes non-compliance with the SORP as a whole (see the Introduction to the SORP paragraph 33). The SORP does require additional reporting by larger charities but this is voluntary for smaller charities. In the Republic of Ireland the requirement for an equivalent to the trustees' annual report has yet to be introduced and so the SORP requirements for a trustees' annual report will be wholly new.

B: The main considerations in making the switch to accruals accounting

This section offers advice on the main considerations that trustees should consider if looking to switch from cash to accruals accounting.

The SORP combines guidance on how to apply the applicable UK-Ireland accounting standard and additional charity specific requirements and explanations. The preparer of the accounts has to consider the 14 core modules (or sections) that cover the essentials that apply to all charities and also identify which, if any, of the additional 15 modules applies to the charity's circumstances. Understanding the SORP and its requirements requires the preparer to be familiar with accounting concepts and terminology. The SORP cross refers to the accounting standard that it is applying and in some instances the preparer will have to refer directly to the standard for items that apply to their charity for which the SORP does not provide any guidance.

Going concern (annex 4) is a concept that underpins all accounts prepared on an accruals basis. Trustees of charities preparing cash accounts may already be familiar with the importance of knowing that their charity has access to enough cash to pay bills as they fall due. Also in looking to the future they may already be setting a budget. By identifying the amount of income they expect to get taken together with the cash they already have in hand or at bank trustees can check that they have enough cash to cover what they expect to pay out. When preparing accruals accounts the expectation is that a more rigorous approach is taken that includes: considering the amounts of debtors and creditors, the expected time of settlement, access to credit if needed, the extent of any financial uncertainty (including any provisions for expected costs), and its current and future prospects (including its track record in forecasting income and expenditure and managing its budget) and the charity's reserves. These considerations are drawn together and documented by the trustees including their decision as to whether their charity is a going concern or not.

Materiality (annex 5) is about the exercise of judgment in identifying which accounting policies to apply to items, whether to report separately or aggregate (combine) two or more items in the accounts and about deciding which items to disclose separately in the notes to the accounts. The intention is to avoid cluttering the presentation and contents of the accounts with insignificant or irrelevant items so that the reader of the accounts can focus on the material items important to their decision-making about the charity. The SORP sets out a definition of materiality in its glossary (SORP appendix 1 glossary of terms).

Accounting policies (annex 5) are the approaches taken and methods followed in treating each material item included in the accounts. Cash accounting by its nature is simply reporting changes that affect the balance of cash held but accruals accounting includes non-cash items. Taken together accounting policies set out the basis on which the accruals accounts are prepared, for example the identification and treatment of income, expenditure, assets, liabilities and funds held. The SORP sets out what the accounting policies should be for each item in the accounts by topic in each of its modules. Accounting policies are only required for material items.

Timing differences and 'post balance sheet events' (annex 5) are a key area of difference. Cash accounting only focuses on changes to cash that happen in the accounting period reported irrespective of the timing of the event that gave rise to the transaction or the period of time that transaction covers. In some situations this may not cause a difference. For example in paying a monthly payroll for a member of staff but in some instances it matters. Examples where it matters include: paying for two year's rental on a property up front, receiving income in advance of delivering an activity, being entitled to a legacy gift which has yet to be paid over. Accruals accounts attribute income and expenditure to the accounting period to which they relate and not the timing of cash settlement. Trustees are responsible for signing off the accounts. This happens after the year-end when the accounts are prepared. In cash accounting nothing changes in this intervening period because the year-end cash figure is fixed. In accruals accounting trustees must consider any change in circumstances that are adjusting events because that requires a change to a figure shown in the accounts. A change may be required because new knowledge has come to light that is relevant to the financial year-end and this came to light before the accounts were signed off.

The format of the accounts (annex 6) is very different to cash accounts in respect of the headings of the accounting statements and the format and content of the accounting statements. Depending upon the charity law jurisdiction, there may be very few formatting requirements for cash accounts and, aside from a distinction of cash income from cash spending, little specified in terms of form and content of the accounting statements. Accruals accounts are defined in the applicable regulations and the SORP specifies the headings, format and content to a great degree. The SORP does allow smaller charities the freedom to adopt an alternate presentation to its standard activity based approach.

Notes to the accounts (annex 6) are few for cash accounts and in some jurisdictions there may be no requirement for any notes at all whereas accruals accounting requires extensive notes to the accounts. These notes set out items in greater detail and provide insights into how the accounts were prepared, for example the accounting policies adopted. For each applicable item of income, expenditure, assets, liabilities and funds held explanatory notes are required. The preparer therefore needs to familiar with the SORP and carefully identify all the notes needed.

Income (annex 7). Two main differences to cash accounting are: firstly income is shown in the accounts when the criteria for recognising income are met and not on the basis of the timing of cash settlement and secondly income received in advance of providing service is seen as a prepayment and is deferred (a form of creditor) until such time as the criteria for income recognition are met. Income is also normally shown gross. If there are bad debts these are treated as a reduction to the gross income as shown in the accounts. In a further complication, if extended credit is offered to a customer of the charity beyond the charity's normal terms of business then this is treated as having an interest element to it.

Assets (annex 7). Although the treatment of cash is the same in both accruals and cash accounting, there the similarity ends. In some jurisdictions in cash accounting the charity is required to list the assets held with either the option of attributing a value to them or it may be required to attribute a value to them. In cash accounting the gain or loss, increase or decrease in asset's value is not shown in the cash accounts, which means that the figure for retained funds, if a total is quoted or required, is a balancing figure. In accruals accounting any gain or loss is taken through the Statement of Financial Activities and is part of reporting the charity's financial performance. Also accruals accounting requires assets to be valued using an approved method at fair value, or alternatively, where permitted, at historical cost with evidence to support the valuation, the method chosen and the value(s) reported. At the reporting date assets are also tested for any loss in value due to impairment and for certain assets, which are treated as having a specific economic (useful) life, a reduction is made for depreciation.

Expenditure (annex 8). Similar to income, expenditure is shown in the accounts when the criteria for expenditure recognition are met and not on the basis of cash settlement. Where a charity has made prepayments these are not treated as spending but treated as a form of debtor (money owed to the charity) until such time as the criteria for expenditure recognition are met. With few exceptions expenditure is also shown gross and is not netted off against income. Also non-cash items are included as expenditure attributable to the reporting period, for example charges for depreciation and impairment, constructive obligations committing a charity to expenditure and provisions for expenditure. The SORP also has a requirement to aggregate items of expenditure by activity undertaken unless a charity is classed by the SORP as a smaller charity in which case it has a choice of adopting an alternative analysis of expenditure. This is different to cash accounting where, depending upon jurisdiction, trustees may enjoy the freedom to show spending under any kind of heading that they choose.

Liabilities (annex 8). Accruals accounting requires that any liability arising from a past event that happened during the reporting period is included in the accounts whether or not cash settlement was made in the reporting period. Liabilities can arise from money owed to creditors, provisions made for constructive or legal obligations that committed the charity to expenditure, and due to outstanding loans.

Fund accounting (annex 8). All charities in their accounting records must distinguish between unrestricted funds (funds that can be used for any of the charity's charitable purposes) and restricted funds (funds that can only be used for one or more specific charitable purposes). In accruals accounting, the SORP requires that these are always reported with a distinction made, where appropriate, between restricted income funds and endowment funds. Depending upon the jurisdiction, in cash accounting funds either have to be reported in the same way or the trustees have discretion as to how the funds are reported either with a separation or as a single total funds column. The SORP requires a fund analysis note identifying the movement on individual material funds and overall for each class of fund whereas this requirement is not found in cash accounting.

C: The role of the independent examiner in reviewing accruals accounts

The three UK charity law jurisdictions have established independent examination as an external scrutiny regime for smaller charities in place of requiring an audit. Those charities already meeting the eligibility criteria to prepare cash accounts (receipts and payments accounts) will have this choice of independent examination. In the Republic of Ireland the regulations bringing independent examination into effect have yet to be made.

In the UK jurisdictions the independent examiner does not give an opinion as to whether the charity's accounts are true and fair or not but they do consider the extent to which those accounts comply with the applicable regulations as to the format and content of accounts and their consistency with the accounting records. Since the regulations cite adherence to the SORP the examiner will consider if the SORP has been referenced in the notes to the accounts and, depending upon the jurisdiction, any significant non-compliance with the methods and principles of the SORP.

A departure from the methods and principles of the SORP may be reported as part of the independent examiner's report. In all three UK jurisdictions a failure to prepare the accounts in the correct format will be reported. The legislative basis for charity accounts is set out for each jurisdiction in annex 2. SORP compliance also features to some degree in the work of the independent examiner but the emphasis placed on this differs between the UK jurisdictions. The extent of the independent examiner's review of SORP compliance is considered for each jurisdiction in annex 10.

The Association of Charity Independent Examiners (ACIE) offers training and support to individuals acting or wishing to act as independent examiners and offers a professional qualification to any member who demonstrates that they have the requisite ability and practical experience to carry out a competent independent examination (IE). ACIE is one of a number of professional bodies that are listed in the respective Charities Act for each UK jurisdiction whose members are able to undertake an IE, however it is the only one which is solely established for IE.

Those licenced by ACIE to carry out IE's are expert in charity independent examination and from their experience the common problems that their members identify when examining charities making the switch from cash to accruals accounting are:

- Lack of understanding by the trustees of the differences between accruals and cash accounting
- The increased complexity leads to additional time spent in both preparing SORP accounts and the examination thereof and so an allowance should be made for the increase in the fees charged by the examiner.
- Restating the prior year figures in making the switch requires preparation
- If the income in the current year exceeds £500,000 the need to prepare cash flow statement and having the information for that.
- Distortions between accruals and cash accounting over multiple years may lead to incorrect reporting if these differences are not appreciated
- Particular problem areas are on VAT and PAYE where cash accounting is harder to manage these properly when using accounting software

D: Sources of help and advice

In respect of accruals accounts the Charities SORP-making body and the charity regulators provide a lot of helpful information. Understanding this information does require a level of understanding of accountancy methodology, terminology and concepts. Annex 10 provides useful web links to free sources of advice and guidance.

In addition you may wish to contact your sector umbrella body if you have one as they may have accounts templates you can use or other sources of help and advice.

Members of professional accountancy or other bodies may find that their professional body has sources of free advice, a help-line or similar facility.

About the authors

The principal author, Nigel Davies FCCA DChA is a member of ACCA's trustees' community and principal author of the ACCA Companion Guide for Not-for-profits to the IFRS for SMES.

Also contributing to this factsheet is Mark Heaton FCCA FCIE DChA, chair of trustees of ACIE who is also a director in an accounting practice which works with a number of charities and not for profit organisations. Flowcharts comprising Annexe 3 are reproduced with the permission of Michael Brougham MCBI FCIE

Annex 1 Thresholds – calculating a charity's gross income

The law and charity accounting in the UK and Ireland
Each charity law jurisdiction has taken its own approach to regulating charities within its jurisdiction and this includes specifying the options for preparing charity accounts. The accounts choice is subject to a charity not being established as a chartable company and its income in the reporting period not exceeding the income threshold above which accruals accounts must be prepared. (Charitable companies must prepare accounts on a true and fair basis which requires accruals accounts.)

The calculation of gross income and the income thresholds and the requirements, if any, as to form and content differ for cash accounts do differ between the jurisdictions. The three UK jurisdictions all require accruals accounts to 'true and fair' and make explicit reference to the Charities SORP whereas in the Republic of Ireland the only formal requirement in respect of accruals accounts is for 'true and fair'.

Definition of gross income and the requirement to prepare accruals accounts
The definition of income matters because once the threshold for accruals accounts is passed, cash accounting is not an option. Each jurisdiction is considered in turn.

England and Wales
Legal basis
Section 353 of the Charities Act 2011 defines gross income as: 'its gross recorded income from all sources including special trusts' but from this section we also know from the definition of permanent endowment that endowment funds are not classed as income.
Application
The Charity Commission for England and Wales provides an interpretation of the definition of gross income in its Charity Annual Return 2023: question guide.

- For cash accounting gross income is: 'total receipts recorded in the statement of accounts minus any endowment received in the year (as this is unavailable for spending) add any amount transferred from endowment funds into income funds during the year (as these are now available for spending) minus loans received during the year and minus proceeds from sale of fixed assets'.
- For accruals accounting gross income is: 'total income recorded in the statement of financial activities (prepared in accordance with the Charities SORP (FRS102)) minus any endowment received in the year (as this is unavailable for spending) add any amount transferred to income funds during the year from endowment funds (as these funds are now available for spending)'.

Northern Ireland
Legal basis
Section 180 of the Charities (Northern Ireland) Act 2009 defines gross income for a charity as: 'its gross recorded income from all sources including special trusts'. Section 1(3) defines permanent endowment and such endowment funds are not classed as income.
Application
The Charity Commission for Northern Ireland interprets the definition of gross income in its guidance for trustees: Charity reporting and accounting: the essentials- June 2019. Gross income is defined as:

- For accounts prepared on a receipts and payments basis gross income is simply the total receipts recorded in the statement from all sources excluding the receipt of any endowment, loans and proceeds from the sale of investments or fixed assets.
- For accruals accounts this is the income from all sources in the accounting period, including the conversion of endowment to income, but excluding: gifts of endowment, net investment gains/(losses), all revaluation gains/(losses) on retained assets not due to impairment, actuarial gains/(losses) and such other gains(losses) that are excluded by accounting standards from the calculation of net income.

Republic of Ireland

Legal basis

Section 48 of the Charities Act 2009 provides for the Minister to make regulations in respect of the accounts of a charity.

Application

It is anticipated that when the accounting regulations are made this will include a definition of gross income.

Scotland

Legal basis

Section 44 of the Charities and Trustee Investment (Scotland) Act 2005 provides for the Minister to make regulations in respect of the accounts of a charity. The Charities Accounts (Scotland) Regulations 2006 (as amended by The Charities Accounts (Scotland) Amendment Regulations 2010) defines gross income as: 'the total incoming resources of the charity in all restricted and unrestricted funds but excluding the receipt of any donated asset in a permanent or expendable endowment fund'.

Application

In *A Guide To Charity Accounts* (April 2019), the Office of the Scottish Regulator considers gross income to be: 'A charity's gross income is the total incoming resources of the charity in all restricted and unrestricted funds but excluding the receipt of any donated asset in a permanent or expendable endowment fund. Any income that has been collected specifically for, and passed onto, a third party (e.g. that part of a membership fee that is passed onto a parent body, or a collection held for another charity) should be excluded. However, the transferred amount should be recorded by way of a note to the accounts'.

SORP definition of gross income

The SORP definition of income is found in paragraph 4.7 of module 4 and is also shown diagrammatically in table 2. In respect of charitable companies, a SORP Information Sheet offers a solution to identifying a charity's income when applying requirements under company law. Refer to SORP Information Sheet 3: The Companies (Miscellaneous Reporting) Regulations 2018 and UK Company Charities.

Annex 2 Law, GAAP, the SORP and 'true and fair' accounts

In all UK and Irish jurisdictions the requirements for charitable companies as to the keeping of accounts are set out in company law for charitable companies with all other forms of charity having their requirements set out in charity law. This annex recognises this distinction with a separate section for charitable companies.

England and Wales

The Charities Act 2011 sets out the current accounting framework and options for charities in England and Wales. Section 132 provides for the Minister to make regulations as to what accounts are kept and section 133 allows trustees of lower income charities the option of preparing cash accounts (referred to as receipts and payments accounts). This section defines lower income charities as those with a gross income not exceeding £250,000. Section 135 provides that the sections of the Act referring to the preparation and preservation of individual accounts do not apply to a charitable company and under UK company law a company is not permitted to prepare cash accounts. The Charities (Accounts and Reports) Regulations 2008 require that charity accounts prepared on a fully accrued basis (regulation 8) are to be true and fair in accordance with the methods and principles set out in the SORP. The 2008 Regulations cited SORP 2005 and although the current SORP was published in 2014 the Regulations have not been updated to reflect this and so the charity regulator issued advice on how to handle this situation (see annex 10).

Northern Ireland

The Charities (Northern Ireland) Act 2008 sets out the current accounting framework and options for charities in Northern Ireland. Section 64 provides for the Department to make regulations as to what accounts are kept and allows trustees of lower income charities the option of preparing cash accounts instead (referred to as receipts and payments accounts). This section defined lower income charities as those with a gross income not exceeding £100,000 but this threshold was subsequently raised to £250,000 (the Charities Act 2008 (Substitution of Sums)(Northern Ireland) Order 2015). Section 64 provides that the provisions of the Act referring to the preparation and preservation of individual accounts do not apply to a charitable company and under UK company law a company is not permitted to prepare cash accounts. The Charities (Accounts and Reports) Regulations (Northern Ireland) 2015 require that charity accounts prepared on a fully accrued basis (regulation 8) are to be true and fair in accordance with the methods and principles set out in the SORP.

Republic of Ireland

Charities Act 2009 sets out the current accounting framework and options for charities in the Republic of Ireland. Section 48 provides for the Minister to make regulations as to what accounts are kept and also allows trustees of lower income charities the option of preparing cash accounts instead (referred to as an 'income and expenditure account' but note this term was not intended to have the same meaning as that used in company law). This section defines lower income charities as those with a gross income not exceeding €100,000. Section 48 provides that the sections of the Act referring to the preparation and preservation of individual accounts do not apply to a charitable company and under company law in the Republic a company is not permitted to prepare cash accounts. As yet the relevant Regulations have not been made and so there is no specific format prescribed for charity accounting and so the Charities SORP is voluntary in its application. Also it is also anticipated that the lower income threshold will be raised on passage into law of the Charities (Amendment) Bill.

Scotland
The Charities Trustee Investment (Scotland) Act 2005 sets out the current accounting framework and options for Scottish charities. Section 44 of the Act sets out what accounts are kept and makes provision for the Minister to make regulations about them. The Charities Accounts (Scotland) Regulations 2006 regulation 8 provides for charities over £100,000 to prepare accrued accounts (this income threshold was subsequently raised to £250,000 by the Charities Accounts (Scotland) Amendment Regulations 2010) and regulation 9 provides for other smaller charities to prepare cash accounts, referred to as receipts and payments accounts, with an option to prepare accruals accounts instead. (However note that charitable companies under UK company law are not permitted to prepare cash accounts.) Schedule 1 to the 2006 Regulations requires fully accrued accounts to be prepared in accordance with the methods and principles set out in the SORP and for these to be true and fair. The 2006 Regulations cited SORP 2005 but the Charities Accounts (Scotland) Amendment Regulations 2014 subsequently updated this reference to the current SORP.

Company law and accounts options for charitable companies

UK charitable companies
The Companies Act 2006 sets out the accounting framework for UK companies including charitable companies. This Act makes no reference to the Charities SORP but it does reference accounting standards (section 464) and notes any reference made to accounting standards applicable to a company's annual accounts are to such standards as are, in accordance with their terms, relevant to the company's circumstances and to its accounts. Section 393 requires the accounts to give a true and fair view. Section 474 provides that in the case of an undertaking not trading for profit, any reference in Part 15 to a profit and loss account is to an income and expenditure account. The reference to accounting standards and ‘true and fair’ in the Act is key because adherence to accounting standards is considered to be the mechanism by which true and fair accounts are prepared and these standards do refer to following an applicable SORP (see accounting standard FRS100 Application of Financial Reporting Requirements).

Scottish charitable companies
An extra consideration is that the provisions set out in, and regulations made under, the 2005 Act with respect to the form and content of accruals accounts apply equally to Scottish charitable companies with respect to the format of their accounts and so these requirements are additional to the obligations and requirements of the Companies Act 2006. This is not the case for charitable companies in England and Wales or Northern Ireland.

Republic of Ireland Charitable Companies
The Companies Act 2014 sets out the accounting framework for Irish companies including charitable companies. This Act makes no reference to the Charities SORP but it does include a reference to accounting standards (section 291 and schedule 3). Schedule 3 to the Act requires that the directors shall have regard to the substance of the reported transaction or arrangement in accordance with applicable accounting standards. Section 289 requires the accounts to give a true and fair view. The Companies Accounting Act 2017 amended the

2014 Act to stipulate that in the case of an undertaking not trading for profit, any reference in section 274 to a profit and loss account is to an income and expenditure account.

Special cases where an alternate regime to the SORP will apply

Some charities may not apply the SORP because:

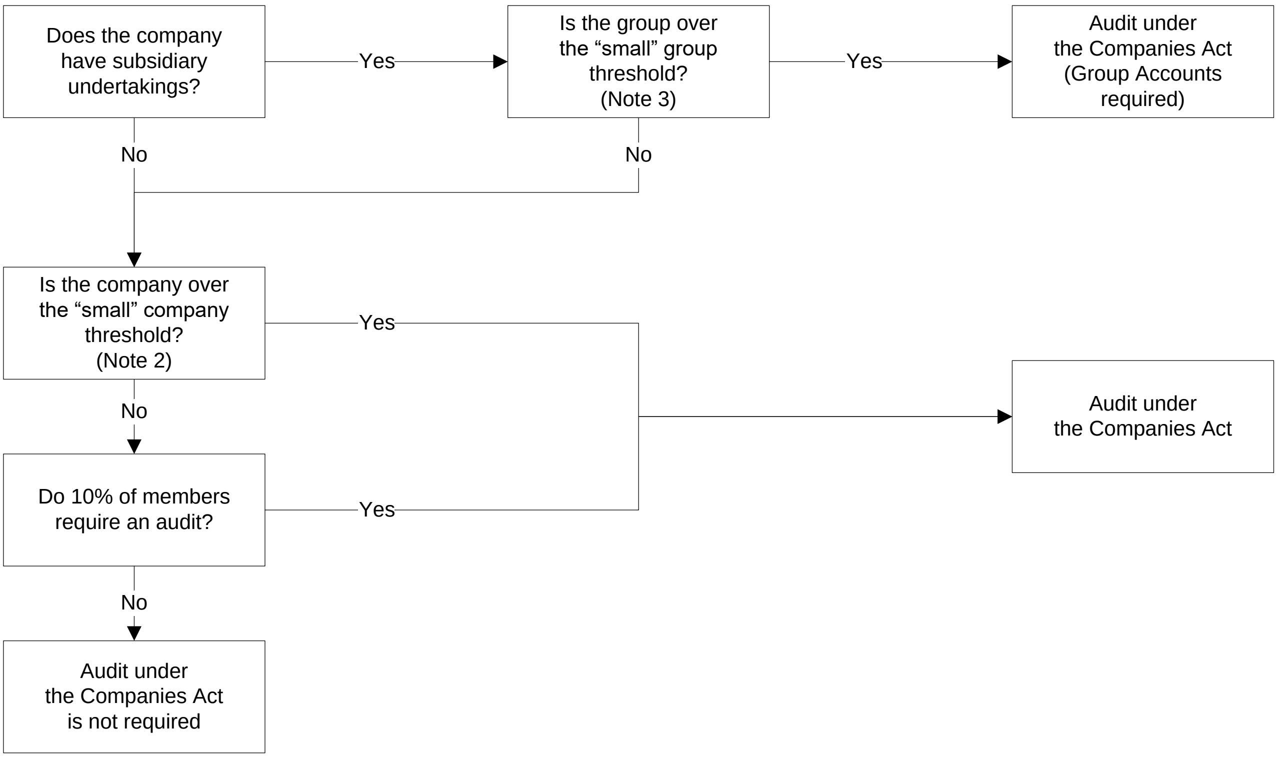
- An alternate SORP applies for example Charitable Investment Funds, Registered Social Landlords or Higher and Further Education (see also reference in Charities SORP Introduction paragraph 15).
- The Charities SORP has not been adopted by that jurisdiction - this is the case in the Republic of Ireland.
- Charities are scoped out of applying the SORP by statute or regulation.
- As eligible charities they opt instead to prepare the charity's accounts on a cash basis

Annex 3 External scrutiny requirements for UK charities

Annex 3 comprises four flowcharts:

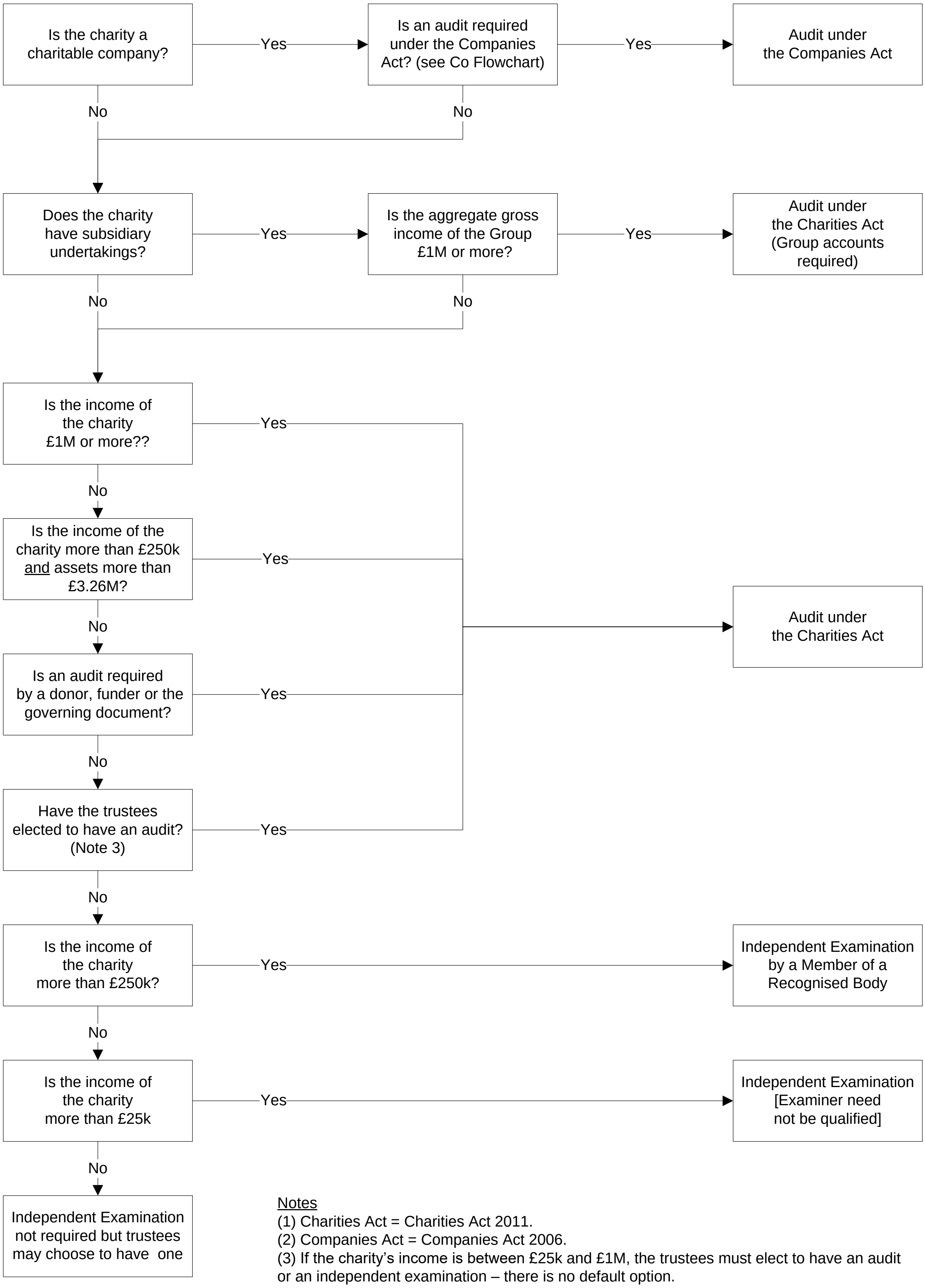
- All UK companies including charitable companies
- Charity Law requirements England and Wales
- Charity Law requirements Northern Ireland
- Charity law requirements Scotland

Audit Requirements under the Companies Act 2006



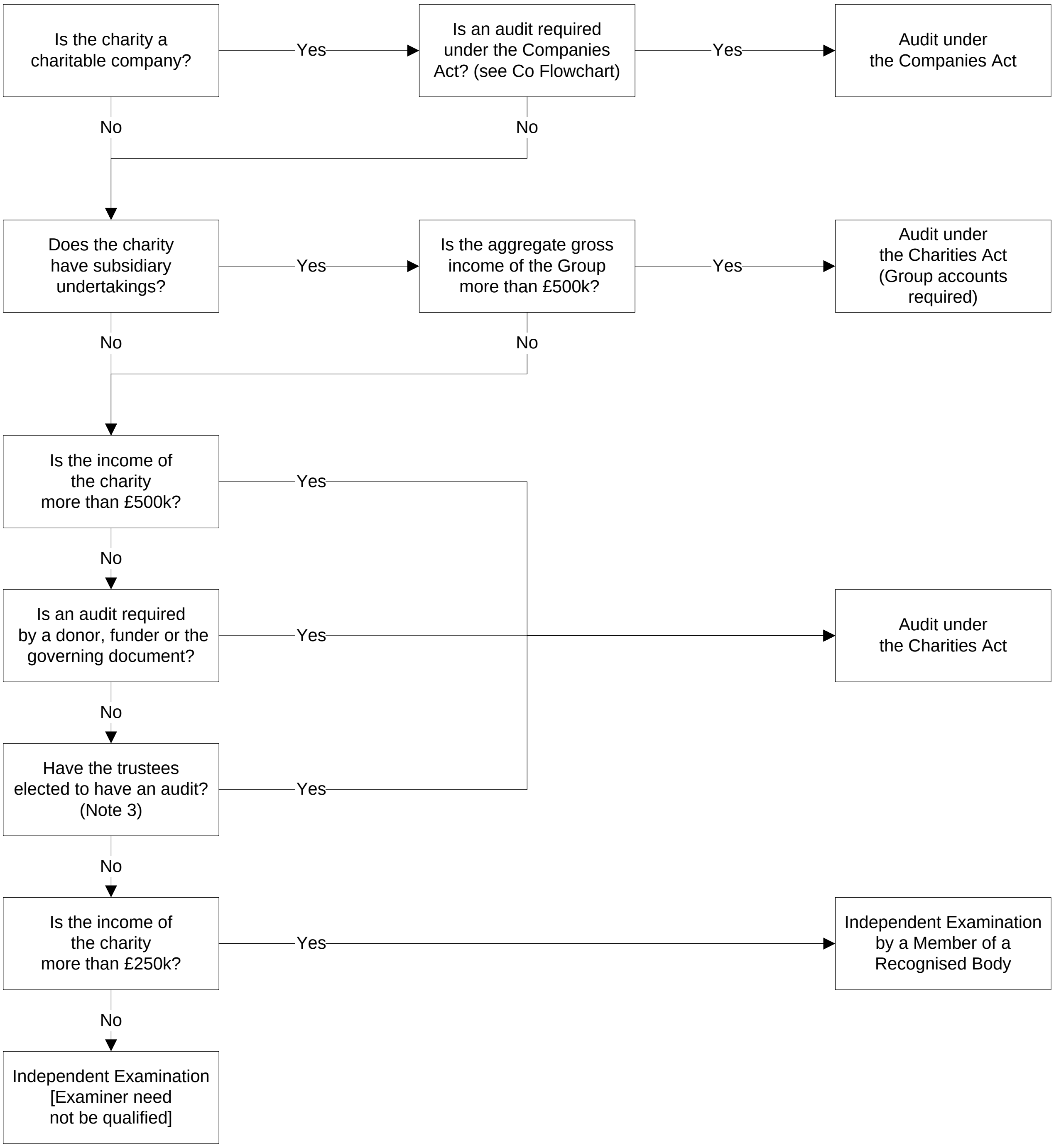
<u>Notes</u>
(1) Companies Act = Companies Act 2006.
(2) Small Company = at least two of: Income < £10.2M; Assets < £5.1M; Employees < 50 in both the current and the previous year.
(3) Small Group = at least two of: Income < £10.2M net (or < £12.2M gross); Assets < £5.1M net (or < £6.1M gross); Employees < 50 in both the current and the previous year.
(4) In the event that accounting period is <> 12 months, the income threshold is adjusted -/+ proportionately.

Scrutiny of Charity Accounts in England & Wales



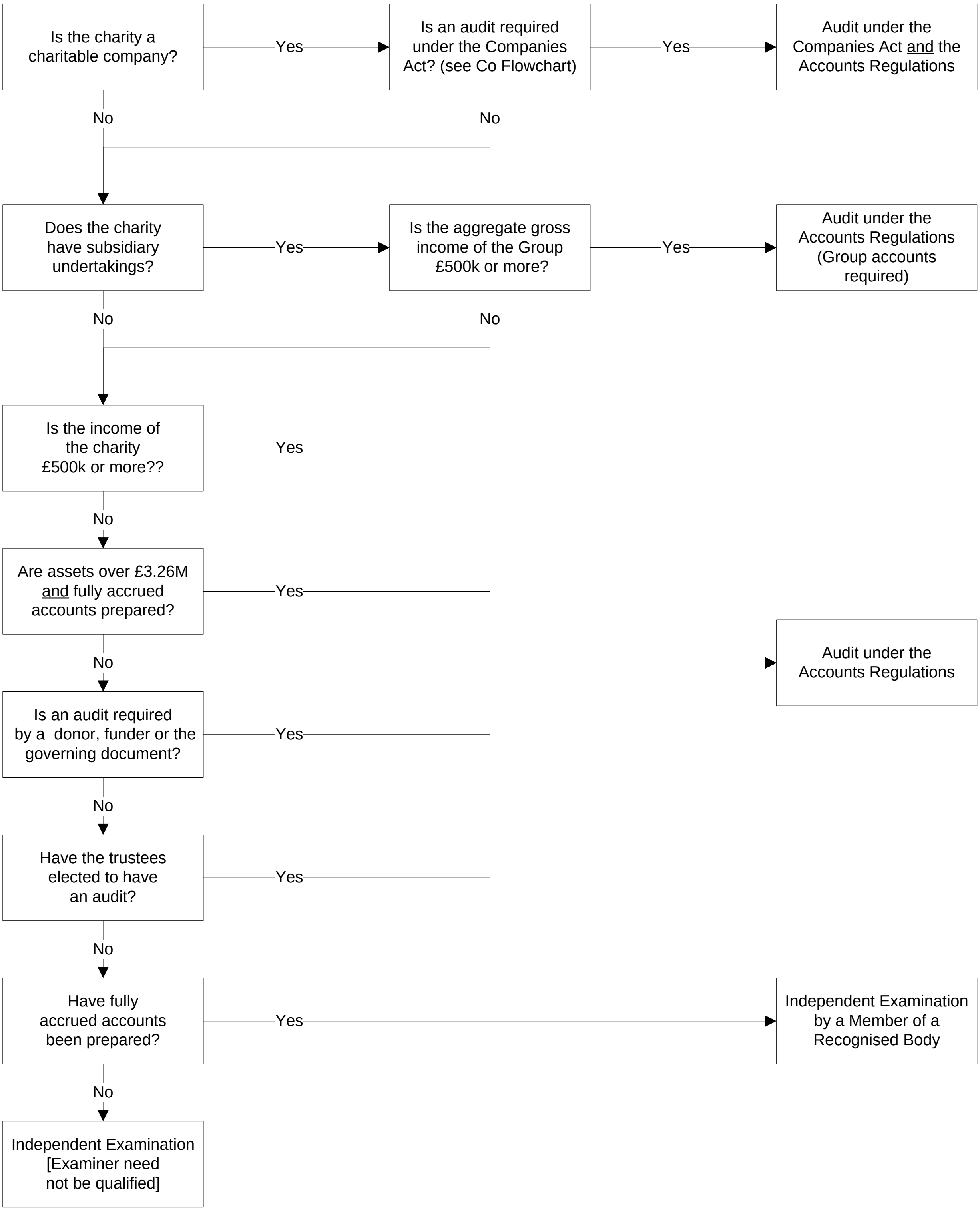
<u>Notes</u>
(1) Charities Act = Charities Act 2011.
(2) Companies Act = Companies Act 2006.
(3) If the charity's income is between £25k and £1M, the trustees must elect to have an audit or an independent examination – there is no default option.
(4) The Charity Commission has the power to grant dispensation from statutory audit under the Charities Act (but not under the Companies Act).
(5) The above chart cannot be used for Co-operative & Community Benefit Society charities.
(6) Refer to Appendix 2 for the definition of income.

Scrutiny of Charity Accounts in Northern Ireland



<u>Notes</u>
(1) Charities Act = Charities Act (Northern Ireland) 2008.
(2) Companies Act = Companies Act 2006.
(3) The trustees must elect to have an audit or an independent examination – there is no default option.
(4) The Charity Commission has the power to grant dispensation from statutory audit under the Charities Act (but not under the Companies Act).
(5) Charities that are not yet registered with the Charity Commission for Northern Ireland are not required to comply with the scrutiny requirements of the Charities Act (but are required to comply with the Companies Act, if applicable), although it is good practice to do so.
(6) Refer to Appendix 2 for the definition of income.

Scrutiny of Charity Accounts in Scotland



<u>Notes</u>
(1) Accounts Regulations = The Charities Accounts (Scotland) Regulations 2006 (as amended).
(2) Companies Act = Companies Act 2006.
(3) The above chart cannot be used for Co-operative & Community Benefit Society charities.
(4) Refer to Appendix 2 for the definition of income.

Annex 4 Going concern

Trustees in acting prudently should always consider if their charity is financially able to continue and make adjustments if they are facing a financial shortfall. The action taken when facing a shortfall may even include orderly winding down and closure in some cases. This idea of on-going financial sustainability is behind the concept of going concern.

In cash accounting going concern might be simply thought of as having the cash to settle bills and meet cash obligations in a timely way as they fall due. Many smaller charities may have been doing this informally by thinking about their charity's finances at trustees' meetings, however in accruals accounting a greater rigour is required. The SORP requires a forward look of at least 12 months from the date the trustees approve the accounts (which will be some time after the charity's financial year-end). Auditors will always want to see evidence of this review by the trustees and, depending upon the jurisdiction, even where an audit is not required so may a charity's independent examiner.

The relevant SORP module is module 3 paragraphs 3.14 and 3.38. A discussion of going concern is also recommended as a feature of the trustees' annual report- see module 1 paragraph 1.23.

Factors trustees are advised to consider in thinking about going concern:
In cash accounting going concern is not a feature because cash accounts simply record money coming in and money going out during the reporting period. There is no forward looking element in terms of anticipating the impact on financial performance of changes to assets or liabilities resulting from the charity's activities in the reporting period which have yet to affect the cash position. That said, depending upon the jurisdiction, some information about these non- cash assets and liabilities may be required when preparing cash accounts. The situation is very different for accruals accounting.

In preparing accruals accounts, it is for the trustees to decide that they are able to prepare their charity's accruals accounts on a going concern basis. Going concern though is about more than just its cash position and takes into account the timing of future settlement of liabilities, likely future income, anticipated gains or losses, the effect of settling obligations that may have been reflected in a provision in the accounts and the charity's liquidity position in terms of available cash, access to credit and its capability of generating more cash.

The essential elements of a forward look and testing for going concern are:

Reserves and the reserves policy
Depending on the jurisdiction the applicable regulations may require either that the charity discloses it has a reserves policy or confirms that it does not have one. This applies irrespective of the form of accounts prepared. Trustees should therefore have a view as to what reserves are needed, how much they have and what they count as reserves. A well governed charity will have a discussion of both the cash position, and the reserves position when discussing the charity's finances. Whether a regulatory requirement to report on reserves exists or not, having reserves provides a financial buffer to help a charity continue to operate.

The SORP requires trustees have a policy or state if they do not have one (paragraph 1.22) and to state the amounts of those reserves and why they are held (paragraph 1.22). The SORP also offers an approach to calculating reserves which excludes restricted funds, designated unrestricted funds and funds that can only be realised by disposing of tangible fixed assets and programme related investments (paragraph 1.48) or the charity may disclose its own approach.

Forward look

Prudent trustees look ahead to see if their charity is capable of continuing to carry out its activities as planned and if not they consider what to do about it. For cash accounting this is likely to involve considering the amount held at bank and/ or in cash, the expected cash income and expected cash outgoings in looking ahead. That forward look might be just until the next trustee meeting takes place but ideally this exercise is done for the whole year ahead and then reviewed at each trustee meeting. The review considers what was expected, what happened and how the rest of the year looks to be going and what, if anything, needs to be done to manage the money to the year-end. There should be a link between this review and the setting and monitoring of a formal annual budget, assuming the charity has one.

Accruals accounting takes this thinking a step further by considering the timings and consequences of anticipated financial events both favourable and unfavourable along with the financial context for the charity. This context comprises: identifying the available reserves, trends in operating surpluses (or deficits), and the availability of credit and ease of selling assets to obtain cash if needed.

The cash flow forecast

A tool used to consider the anticipated flows of money into and out of the charity. At its most simple a cash flow forecast for a charity, which has no staff or contractual commitments, might look at the pattern of likely income and spend for the next 12 months and note the effect this has on the balance at bank and available reserves. This might be based on the experience of the last year amended for any known changes, for example a vehicle purchase. Charities with greater scale employing staff, having contractual commitments, rent or lease payments and that might be invoicing for goods and services and also of anticipated ad-hoc payments for example grants made, replenishing stock, buying materials, and purchases of significant items. This exercise involves combining knowledge of: due dates of invoices, payment runs, settlement dates, payroll runs, and history of aged debtors.

Ideally these cash flows are mapped at least monthly so that the charity’s liquidity can be assessed in terms of the rate of drawing down (or building up) its reserves, the available cash (taking account of drawing down on accessible credit), the timing of selling assets if needed, and its ability to cover routine spending eg monthly payroll, rent, and utilities. Depending upon their complexity and financial circumstances some charities could be predicting income and spend on a weekly basis for the 12 months ahead.

As the year unfolds material unforeseen flows of cash (favourable or adverse) will need to be reflected in the trustees’ thinking and used to revisit the forecast for the months ahead. Ideally this forecasting and review is updated on a rolling 12-month basis in order to be sufficient to inform the trustees’ judgement about going concern. Charities facing a material uncertainty as to going concern might be expected to forecasting at least weekly and perhaps even for each day ahead until their charity's financial position improves. However frequently undertaken, the initial forecast income and spend should correlate with the expectations in the budget plan and budgets are normally monitored each month with income and spend mapped against budget both cumulatively (year to date) and in month.

The SORP requires that the trustees look ahead a minimum of 12 months from the date the accounts are approved (paragraph 3.14), which will be a date subsequent to the charity's financial year-end. The context of the charity's financial situation and prospects should inform this forward look and cash flow forecast.

Budgetary projections
A planning and organising tool that helps trustees consider the foreseeable financial demands and commitments to expenditure against the likely available income. The budget process is a forward look which identifies any planned shortfall in funds that then needs to be drawn from reserves or financed by borrowing or additional income generating activities such as a fundraising appeal. Alternatively it may show a building up of reserves if expected income exceeds forecast expenditure. For trustees used to running their charity on an informal basis and not having a budget written out formally identifying items of expected income and expenditure for the charity as a whole and having a budget will be a change to practice. Not having a budget will make it harder to justify the going concern statement because if trustees are not looking formally at the year ahead then how do they know that their charity is financially sustainable and also how can they demonstrate this to their auditor or independent examiner if asked?

Deviations from budget help identify unforeseen developments and prompt questions as to how these came about, the impact (beneficial or adverse) and any action that needs to be taken. In the context of going concern, the budget scenario facing the trustees will affect the nature of their plans for the year and whether they are having to scale back or abandon those planned activities or are able to grow or expand their activities, thereby revealing how sustainable the charity's financial position is and the size of any funding gap and whether it can be bridged or not.

Trustees' discussion of financial risks and/ or reserves is ideally continuing throughout the year so that financial challenges and opportunities and their implications for the reserves, operational activities of the charity and its future plans can be considered. In cash accounting this might simply be a recap at each trustees' meeting of the current financial situation, available cash at bank and/ or cash in hand and a reflection on whether things are going well, as planned, or turning out badly or a concern. Ideally though it extends much further to discuss potential funding problems, challenges and risks and opportunities. Examples of a risk might be in having to call off an outside activity due to poor weather and the impact on income and expenditure if this happened or of performing a new show and the impact if ticket sales were to fall short of breaking even. An opportunity might be bidding for a grant to improve the building and how this helps bring in new income and the impact on expenditure of the works or launching a new fundraising campaign and the costs involved and the expected income from donations. This discussion should form a part of the routine conversation about the charity's finances and financial prospects.

Conclusion
As noted above, both cash flow analysis and budget deviations are dynamic and will have to be reviewed throughout the year in the light of new information about the timing and trends in income and expenditure. In the context of going concern, the current scenario for cash and budget performance facing the trustees will affect the nature of these discussions and the judgment that they make at the time of preparing and signing the accounts about whether their charity is a going concern or not.

The judgment made by the trustees at the time that the accounts are signed that the charity is a going concern may be subject to the disclosure of a material uncertainty as to going concern (SORP paragraph 3.38). This is the case due to some of the risks identified to going concern or because of an adverse trend of accumulating deficits which lends a degree of doubt. If the degree of doubt is too great or closure looks imminent or likely then the charity is not a going concern and the accounts must be prepared on alternate accruals basis (see ACCA factsheet- annex 3). This judgment may be finely balanced.

Annex 5 Materiality, accounting policies and post balance sheet events

Materiality is a term with a specific meaning in accruals accounting and is applied to all aspects of the accounts and notes to the accounts, including accounting policies. In cash accounting this term is not often used. Depending upon jurisdiction the trustees decide on how much detail to provide in the accounts and how to analyse income and spend in the accounts, subject to any particular requirements as to formatting as set out in the applicable regulations. It can be quite a change to aggregate or combine things in a single heading in the accounts and to appear to miss out some things because these are not material to the accounts. The idea behind materiality is to avoid cluttering the accounts with too much detail or small items likely to be irrelevant to the decision-making of the reader.

It is important to be familiar with the term and how to use this concept of materiality as it is applied throughout the preparation of accruals accounts. The trustee or person preparing the accounts must look at the definition given in the glossary to the SORP (appendix 1 glossary of terms) and consider the way materiality is applied- see SORP module 3 paragraphs 3.15 to 3.19. There are some items that the SORP specifies are as always material and there is no trustee discretion about these items. These items of expenditure can be found in module 9 of the SORP.

Accounting policies are the approaches taken and methods followed in treating each material item included in the accounts. Module 3 of the SORP explains accounting policies in general with subsequent modules setting out the particular policies that must be applied if that topic is both applicable and material to the charity. Topics include: income, donated items, expenditure, cost allocation, trustee and staff remuneration, balance sheet items including valuation of assets, provisions and liabilities, impairment of assets, post employee benefits (pensions), heritage assets, different types of investments, and the definition and treatment of branches and group undertakings.

Fund accounting is discussed in module 2 of the SORP and underpins the format of the financial statements. Classes of fund are: unrestricted income funds, restricted income funds and endowment funds. This is a key matter because in some jurisdictions in respect of preparing cash accounts, although the accounting records must always record any restrictions, the reporting of the funds received, spent and held by class of fund is optional and not mandatory.

The impact of having to consider an accounting policy is significant. For example consider a gift in a will to the charity (also known as legacy income). In cash accounting, whether the trustees know about it or not, the gift is only shown upon receipt if it is in cash but if it is non-cash, for example the gifting of a vehicle or building, then it will not be shown on receipt. Instead a non-cash gift is listed (and in some jurisdictions a value is attributed unless this is impractical) in the year-end statement of assets and liabilities or statement of balances. In accruals accounting if the trustees know about a legacy gift before cash settlement is made, for example because the trustees were notified by the executor of the estate, then in most circumstances it is recorded as income with a matching debtor shown on the balance sheet. Refer to SORP module 5 for more information.

Similarly if the trustees make a form of promise to another party to award a grant to them then even though no cash may have been paid over this firm commitment is included in most circumstances as expenditure. Refer to SORP module 7 for more information.

The difference is stark for non-cash gifts. Non cash gifts are not recorded in cash accounting as income because these are not cash receipts but such gifts are usually valued as a form of income in accruals accounting. For example a food bank is gifted grocery items for distribution to needy people. Since these are non-cash gifts no value is attributed to them in cash accounting. In accruals accounting if the gifts are as a whole material in value then these items are either shown on receipt as income and an addition to stock or, if that is impractical, as income at the time of their distribution. Refer to SORP module 6 for more information.

Also some items recorded as cash payments are not treated in the same way in accruals accounting, for example if the charity buys or replaces a vehicle used in its work. In cash accounting this purchase reduces the cash balance held and so is recorded as a form of payment. In some jurisdictions a value may also be attributed to the vehicle in the year-end statement of balances/ assets and liabilities. In accruals accounting the vehicle is an asset with more than one year's life and so it is treated as such. There will need to be an accounting policy that sets out the threshold for capitalisation (below which an item is treated as expenditure in year), how the vehicle is valued on acquisition (on purchase), its expected useful life, and the method of calculating the annual cost for depreciation over that life having allowed for any expected residual value. Refer to SORP module 10 for more information.

Materiality is also important in the selection of accounting policies in the notes to the accounts because if a type of transaction does not apply then the trustees need to disclose one. For example if a charity has no investments other than cash it does not need an accounting policy that deals with the valuation of fixed asset investments (SORP module 10 paragraph 10.44). Also if a transaction type is immaterial and it is not shown as a separate item in the accounts then they need not disclose an accountancy policy for it. For example a charity performing drama and deriving its only income from selling tickets unexpectedly receives an extra amount over the face value of the package of tickets sold for a performance because a patron was so impressed that they paid twice the value of their tickets. The difference between the sale value of the tickets and the income is a donation. In practice this immaterial income would be included in the income from ticket sales because it was small and rarely happens and therefore a specific accounting policy for donated income is not needed (SORP module 5 paragraph 5.10). This is an important consideration if using accounting software as some software may simply replicate all the accounting policies found in the SORP whether these apply or not leaving it to the user of the software to remove those that do not apply.

Materiality has a part to play in the application of accounting policies. For example a charity provides disability aids free to beneficiaries for their personal use on the understanding that they are returned when no longer needed. The range of items supplied includes mobility scooters and a stock of walking sticks. Although both of these items have a useful life of more than one year, mobility scooters cost several hundred pounds each but walking sticks cost only a few pounds each. Given the value of stock the material threshold for treating an item as an asset is say £500. In which case the mobility scooters are likely to be material items and so these would be treated as an asset and valued whereas the same is not true of the walking sticks the individual value of which falls below that threshold. Therefore even though a record is kept of loaned walking sticks and the available stock of them because they are not a material item they would not be recognised in the accounts as an asset (SORP module 10 paragraph 10.37). Instead they would be treated as an item of expenditure as and when they are replaced.

Converting to accruals accounting from cash accounting therefore requires the trustees to consider what the material items are for income and expenditure and assets and liabilities and decide on an accounting policy for each. The SORP offers a lot of this detail with the principles and the method or basis of measurement set out for each topic covered by the SORP. The trustees then apply each accounting policy in the year reported and, if practical, retrospectively apply it to the previous year to derive comparative figures unless it is the first year of the charity's operation. Where retrospective application of an accounting policy proves impractical then this must be disclosed with an explanation given- see SORP module 3 paragraphs 3.4, 3.32, 3.44, 3.45 and 3.49.

Timing differences and 'post balance sheet events' are another area of difference to cash accounting. In cash accounting, aside from carrying out a year-end bank reconciliation to the balance at bank which allows for spending that has happened but has yet to be shown in the balance at bank and deposits that have happened that have yet to be included in the balance at bank, there are no timing differences. The closing cash figure is simply that. In accruals accounting though, as noted in the discussion of accounting policies, items of income and expenditure can be recorded even if the cash settlement is not made in the year reported. Also the accounts are not closed off until the trustees sign them and this timing difference means that if new information comes to light that is relevant to the valuation or measurement of assets and liabilities as at the year-end then the value of any affected items must be adjusted and the impact of this adjustment reported as a change to the accounts. See SORP module 13 for more information.

Annex 6 The format of the accounts

The format of accruals accounts is very different to cash accounting. Depending upon the jurisdiction, the trustees may have a lot of discretion about the format of cash accounts. Only in Scotland are details as to the form and content of cash accounts prescribed in Regulations. (Although for England and Wales a particular note is specified if the charity is a charitable incorporated organisation this falls short of covering the full accounting statements.) In charity accruals accounting, the SORP specifies the form and content of each accounting statement. Those required of smaller charities are the Statement of Finance Activities (SoFA) and Balance Sheet. (The Statement of Cash Flows (module 14) is only required of larger charities but smaller charities can choose to provide one.)

The format of the SoFA is based on income and expenditure with income reported by type of income and expenditure reported on an activity basis (module 4 table 2). Smaller charities can choose to present their expenditure in an alternate way (paragraph 4.22) but fund accounting is mandatory (paragraph 4.10) subject to allowing for materiality (paragraph 4.11). Material items are shown separately (paragraphs 4.14 and 4.15). The activity basis for reporting expenditure requires costs of charity governance and other support costs to be apportioned or allocated across activities and also to be shown separately by way of note (module 8). Some gains and losses are reported separately and not included in income or expenditure (module 4). In cash accounting gains and losses still count if they lead to a cash gain or cash reduction (loss) but these are often shown separately because the definition of gross income used by charity regulators may exclude these items.

The Balance Sheet (module 10 table 5) can be presented on a total funds basis or by class of funds (paragraph 10.9) and the sequence of assets, liabilities and retained funds is set out. Unlike cash accounting all items must be valued unless the SORP permits only disclosure by way of an explanatory note, for example this is an option for some heritage assets (module 18 paragraph 18.14).

Notes to the accounts

In accruals accounting these are different to those, if any, required when preparing cash accounts. In regard to notes to the accounts for cash accounts, in Scotland some notes are required (see part 2 to schedule 3 of the Regulations) whereas in England and Wales specific notes to the accounts are only required of Charitable Incorporated Organisations (refer to The Charitable Incorporated Organisations (General) Regulations 2012 regulation 62) and in Northern Ireland no notes are currently specified. In accruals accounting a standard framework for the presentation and content of the notes to the accounts is required by the SORP for all charities preparing accruals accounts. This is in keeping with accounting standards. The SORP sets out for each of its 14 core modules and 15 topic modules (those only selected if they apply to a charity's circumstances) the notes that are required. The SORP may also suggest some notes that are optional. Materiality considerations apply to the notes, for example if a charity only makes very occasional small grants, which when taken together are not a material amount of expenditure in the year reported, it can omit some details (SORP module 16 paragraph 16.18).

Annex 7 Income and assets

Income

The treatment of income differs by type of income under accruals accounting with a set of principles applied. This is not true of cash accounting which is simply based on cash receipt. The three general principles for income recognition (module 5 paragraph 5.8) are: the charity has entitlement, receipt is probable and the amount can be measured reliably.

The SORP in module 5 distinguishes between income from exchange transactions (for example selling goods or supplying a service for a fee) and gifts (non-exchange transactions). In the case of gifts due to the different nature of this income in some instances non-cash gifts are recognised as income (module 6). Given that not all income is always received in full but can be paid over a period of time a method needs to be applied to reflect performance through time, for example the supply of services by a charity (paragraph 5.43) or income from membership subscriptions (paragraph 5.48). Investment gains are included in the SoFA (see module 4 table 2) but these are shown separately from other types of income reflecting their distinct nature. Even then some kinds of investment have a special treatment except where these relate to a social investment (paragraph 4.41). Gains on the disposal of assets used by a charity in its work are included in other income (module 4 paragraph 4.41 and module 10 paragraph 10.36).

Assets

The approach taken to accounting for assets is very different in accruals accounting to cash accounting. In the UK jurisdictions, Scotland alone requires the valuation of assets where cash-based accounts are prepared except where such a valuation is impractical. In England and Wales, and Northern Ireland the valuation of assets in cash accounting is optional. The only exception to this is cash which is stated at closing value in all three jurisdictions. In cash accounting there are no principles as to how to measure asset values and there is also no requirement for ‘true and fair’ accounts and so trustees enjoy a great deal of discretion as to how to value assets. In accruals accounting a rigorous and uniform approach is taken with all forms of asset. All forms of asset are valued including functional fixed assets used by the charity in its work that are above the accountancy policy threshold for capitalisation unless a specific exception is given. Such an exception can be made for some forms of heritage assets (module 18 paragraph 18.14). For each type of asset there is a particular approach set out in the SORP (refer to modules 10, 11, 17, 20, 21, 25, 28 and 29). Common examples include stock where the method depends on what the stock is used (module 10 paragraphs 10.60 and 10.61) or debtors (module 11 table 7 and paragraphs 11.8 and 11.17). Investments, including investment property, are initially measured at cost and subsequently at fair value (module 10 paragraphs 10.44 and 10.48).

A more complex example is where a charity owns a building and uses it to carry out its charitable work. The trustees will have to value the building initially at its historical cost and thereafter at either historical cost or revaluation (module 10 paragraphs 10.26 and 10.33). If a historical cost accounting policy is adopted (paragraphs 10.14 and 10.26) then this initial measurement alone will be sufficient.

The method of finding this initial value may include one of the following:

- Valuation by a professional valuer of the building and the land on which it stands
- Valuation by a competent trustee or supporter of the land and the building
- Historical documentation that confirms the cost of acquisition of land and building or its construction cost (converted if pre decimalisation)
- Depreciated replacement cost
- Fair value- based on a recent transaction involving a similar/ identical property that is known to the trustees and which can be verified eg an auction outcome, estate agent confirmation of sale, or land registry entry for a sale, or diocese or similar umbrella body confirmation of a similar transaction

This initial figure is then adjusted for the remaining economic life and may be subject to impairment. Impairment might be due to rising damp or disrepair which means it is not fully usable. For example if a drainpipe is not repaired water ingress from rainwater running down the side of the building may cause such levels of damp that one or more rooms become unusable. Given the requirements of accounting standards the SORP does refer to breaking down an asset such as a building into its components where these have different useful lives, for example the roof, electrical, heating, pipework and the like and calculating their depreciation separately (paragraph 10.31) but the trustees may be of the view that a building is best considered as a whole. If the trustees decide that the building has such a long useful economic life that an annual charge for depreciation would not be material then it is advised that they make this practice clear in their accounting policy note on depreciation (module 10 paragraph 10.37) and give their reasons behind this judgment (module 3 paragraphs 3.8 and 3.40).

Land is viewed as a perpetual asset (paragraph 10.30) and so is not depreciated, therefore on initial valuation the value of the land is ideally separately identified from that of the building which sits upon it (paragraph 10.31). (Like any other asset land is tested for impairment because the value of land can be impaired for example due to coastal erosion or environmental contamination.) The value of the land is based upon its current use. Unless there are available norms on which to basis a reasonable estimation (say cost of acquiring a similar sized plot of land as a percentage of the overall build cost for the type of building) then this is likely to need a professional valuation unless the value of the land was separately identified at the time of initial purchase. An exception is land held on a very long lease, for example 999 years or 99 years, which is itself impressed with charitable trusts and for which the charity owning the building pays a nominal ground rent. The charity does not own the land but operates from that land and in these circumstances the land is not valued but the nature of the lease and the amount of ground rent payable are disclosed (module 10 paragraph 10.27).

All assets are tested for impairment at the year-end (module 12 paragraph 12.4) and those assets with an economic life of more than one year will be depreciated (module 10 paragraph 10.29). A carrying value of nil does not mean an asset might not continue to be used or that it has no resale value, for example a vehicle may have been fully depreciated but the charity continues to use it and because it is roadworthy condition on eventual sale a small gain may also be realised. The same is equally true of a building used for the charity's own use. Also, as noted in the consideration of accounting policies, immaterial assets might not be recognised on the Balance Sheet but this does not imply that no record is kept of them or that these items are not useful.

The cost incurred of acquiring assets is not treated as a form of cash expense but shown as the initial carrying value of the asset on the balance sheet (module 10). It is true that cash accounting can also shows this type of spend separately from other cash spending in order to distinguish day to day operating spending from the acquisition of assets.

Annex 8 Expenditure, liabilities and funds

Expenditure

The treatment of expenditure differs under accruals accounting with a set of principles applied whereas cash accounting is simply based on cash being spent. In accruals accounting non-cash items are included as expenditure attributable to the reporting period, for example charges for depreciation which represents the consumption of an asset over its anticipated economic life (module 10) and impairment where the value of an asset is lower than its carrying value (module 12). (It should be noted that expenditure on maintenance is the means by which an asset is kept in use over its economic life and does not extend its life.) If an asset's economic life is likely to be significantly greater than originally estimated then a change to that asset's economic life is treated as a change in estimate- module 3 paragraph 3.35.

Expenditure includes charges for provisions (module 7 paragraph 7.30 and module 10 paragraph 10.77), for example an outstanding legal claim against the charity and for constructive obligations which represent firm commitments (module 7 paragraphs 7.19, 7.21 and 7.26) for example the written commitment to pay a grant. (Allowing an amount for income owing which is unlikely to be received due to bad debts is not treated as a provision rather it is an offset against income- module 11 paragraph 11.20.) Charities involved in supplying goods or services under contract may on occasion need to make allowance for a contract becoming onerous (module 7 paragraph 7.35).

The SORP requires certain items of expenditure to be separately identified whether material or not. The main one is that of related party transactions (module 9). Also the SORP requires certain salary related items are disclosed either in total or in bands (module 9). Trustees of Scottish charities preparing cash accounts will be familiar with the related party note since there is a similar requirement in part 2 to schedule 1 of the 2008 Regulations to disclose any amount of remuneration paid to a charity trustee or person connected with a trustee and transactions between charity trustees and persons connected with a trustee but care should be taken to apply the definitions as found in the SORP (see Appendix 1 glossary of terms).

Investment costs, where identifiable, are treated as expenditure and shown separately if material. Otherwise these investment management costs are offset against investment income (module 4 paragraphs 4.45 and 4.48). Investment losses are included in the SoFA (see module 4 table 2) but are offset against investment gains, if any, and are not shown as an item of expenditure (paragraph 4.59) except where the loss relates to a form of social investment (module 21 paragraph 21.34). Losses on the disposal of assets used by a charity in its work are treated as additional depreciation (module 10 paragraph 10.36).

Liabilities

These are amounts owing to third parties or claims on the charity's resources (module 10 paragraph 10.76). Aside from trade creditors and other creditors (paragraph 10.82) to whom the charity owes money, these include provisions for amounts anticipated to be paid to settle obligations (paragraph 10.77) and amounts paid by customers in advance of a supply of goods or services by the charity (paragraph 10.82). For example if soon after the charity's financial year-end a performing arts charity is putting on a show it may be taking ticket income in advance. Any advance receipts it obtains before the financial year-end will count as prepayments- a form of creditor. Similarly if a charity receives a performance related grant that is awarded for the next financial year but has been paid across early and received before the financial year-end then this counts as deferred income (module 5 paragraph 5.24 and module 10 paragraph 10.82) - a form of creditor. Also if a bill falls across the financial year-end and covers part of the subsequent year and it has yet to be paid then that portion of cost related to the financial year being reported is shown as an accrual (paragraph 10.82).

This is very different to cash based reporting where the timing of payment determines in which accounting year the expenditure is reported. This can be particularly marked with accruals where the cash paid out for say utilities, rates or rent falls across financial years because the amount reported in the accounts as expenditure will differ from the amount of cash actually paid over due to these timing differences. If the trustees decide that these timing differences resulting from accruals are not material in amount and prefer simply to proceed on their existing cash basis then to avoid confusion it is advised that they make this practice clear in their accounting policy note on expenditure and give their reasons behind this judgment (module 3 paragraphs 3.8 and 3.40).

Fund accounting is required of all charities in terms of keeping the charity's accounting records but in presenting cash accounts the degree to which the presentation of income and spending is required by class of fund varies by jurisdiction. In respect of accruals accounting the presentation of each class of fund (known as fund accounting) is always required (SORP module 2) and underlies the presentation of the SoFA (module 4) and Balance Sheet (module 10) and the notes to the accounts (modules 2) and it extends to comparative information (module 3 paragraph 3.49).

Annex 9 The extent to which the independent examiner considers SORP compliance where accruals accounts are prepared

The regulations to bring independent examination into effect have yet to be made in the Republic of Ireland and so this annex considers independent examination from a UK perspective only. Each UK jurisdiction has developed its own framework for independent examination and there are differences in the framework and how it applies, however all have in common that independent examination is a limited form of external scrutiny of a charity's accounts. Another feature in common is that the independent examiner's report (examiner's report) is addressed to the trustees and is a form of negative assurance meaning that the examiner only confirms if certain things have not happened, for example that accounting records have not been kept. Trustees need to be familiar with what the examiner's report covers and what is involved in an independent examination since it is their responsibility to appoint a suitable examiner.

Independent examiners are only required by the regulations to check for certain specific things as set out in the applicable regulations and so do not give an opinion as to whether the charity's accounts are 'true and fair' unlike an auditor who gives an opinion on the accounts. Another difference to audit is that the independent examiner only reports on what the examiner came across in the course of the examination and is not required to plan the work undertaken to actively look for any material misstatement, fraud or other irregularity to do with the accounts. Therefore just because the examiner's report indicates that no problem was found does not necessarily mean that the accounts are fault free or that the examiner is to blame if fault is subsequently found provided the examiner was diligent in their examination. The legal duty is on the trustees to prepare 'true and fair' accruals accounts. (Some jurisdictions specifically allow the examiner to format the accounts for a charity for which they are performing the independent examination and if this is done then any fault with those accounts would lie with the examiner who prepared them as well as the trustee(s) who approved them.)

Each UK charity law jurisdiction is considered in turn with observations given on the extent to which compliance with the SORP in preparing a charity's accounts is a feature of the work undertaken. Independent examiners must read the applicable Regulations and associated guidance (or advice) issued by the charity regulator. Trustees should also note that the examiner may be under a separate legal duty to issue a separate report to the charity's regulator if they come across a specified matter. Further information on this duty can be obtained from your examiner who should be fully aware of this separate legal duty.

England and Wales

The 2008 Regulations (annex 1) require the examiner to report on the following topics in connection with accruals accounts:

- Accounting records have been kept
- The accounts accord with those accounting records
- Format of the accounts – presence of a Statement of Financial Activities and Balance Sheet

- The accounts were prepared in accordance with the methods and principles of the SORP
- Any matter necessary for a proper understanding of the accounts
- Any material expenditure or action not in accordance with the trusts of the charity
- Information required was not provided by trustees
- Any material inconsistency between financial information in the accounts and the accompanying trustees' annual report

The examiner must also follow the Directions for independent examination issued by the Charity Commission for England and Wales. With regard to SORP compliance Direction 7 requires the examiner to consider if related party transactions took place and if so were these disclosed properly as required by the SORP. Direction 8 requires the examiner checks for the reasonableness of any significant estimates or judgments involved in preparing the accounts, that the accounting policies are consistent with the SORP, and whether the accounts are prepared on a going concern basis. Where the examiner identifies a material departure from the SORP then the examiner considers whether it has been adequately justified or explained. Direction 9 specifically refers to considering the charity's financial circumstances and requires the examiner to ensure the relevant disclosures in the notes to the accounts are given and any material uncertainties disclosed. Also the examiner is to check that: 'the trustees' assessment of going concern is reasonable given the available information'. Direction 10 requires the examiner to: 'review the accrual accounts in sufficient detail to be able to identify any significant non-compliance with the methods and principles of the SORP'. If the examiner does find non-compliance then they are to: 'seek an explanation from the trustees and consider the implications for their report'.

Northern Ireland

The 2015 Regulations (annex 1) require the examiner to report on the following topics in connection with accruals accounts:

- Accounting records have been kept
- The accounts accord with those accounting records
- Format of the accounts – presence of a Statement of Financial Activities and Balance Sheet
- The accounts were prepared in accordance with the methods and principles of the SORP
- Any matter necessary for a proper understanding of the accounts
- Any material expenditure or action not in accordance with the trusts of the charity
- Information required was not provided by trustees
- Any material inconsistency between financial information in the accounts and the accompanying trustees' annual report

The examiner must also follow the Directions for independent examination issued by the Charity Commission for Northern Ireland. With regard to SORP compliance Direction 7 requires the examiner to review any related party transactions and notes that: 'partial, incomplete or omitted disclosures are evidence of non-compliance with the SORP as the SORP considers these types of transaction as always being material'. Direction 9 requires the examiner to: 'review the accrual accounts in sufficient detail to be able to identify any significant non-compliance with the methods and principles of the SORP'. If the examiner does then they are to: ‘decide whether or not any noncompliance with the accounting and reporting regulations or the SORP should be identified in the examiner’s report’. Direction 10 requires the examiner to consider any estimates or judgments involved in preparing the charity’s accounts. In particular the examiner is to be: ‘satisfied that accounts are prepared on a basis consistent with the going concern assumption and accruals concept, and evaluate the accounting policies adopted and applied for appropriateness to the activities of the charity, and consistency with the applicable SORP’.

Scotland

The 2006 Regulations (annex 1) require the examiner to report on the following topics in connection with accruals accounts:

- Accounting records have been kept
- The accounts accord with those accounting records
- Format of the accounts – presence of a Statement of Financial Activities and Balance Sheet (including the trustees having prepared these in accordance with schedule 1 which refers to the accounts being prepared on a true and fair basis)
- The accounts were prepared in accordance with the methods and principles of the SORP
- Any matter necessary for a proper understanding of the accounts
- Any material expenditure or action not in accordance with the trusts of the charity
- Information required was not provided by trustees
- Any material inconsistency between financial information in the accounts and the accompanying trustees’ annual report

The examiner should consider the advice issued by the Office of the Scottish Charity Regulator as to the best practice to follow when undertaking an independent examination. Step 5 form and content of the accounts notes that the examiner: ‘must consider whether the form and content of the accounts is in line with the statutory requirements. If they consider that the accounts do not comply in any material respect, they must state this in their report’. Milestone 8 invites the examiner to consider: ‘are the accounts in the appropriate statutory format’?

Annex 10 Website links to sources of free advice cited in the factsheet

SORP related:

The Charities SORP website hosts not just the SORP itself but has a number of help-sheets, and model example accounts.

ACCA factsheets:

Going concern and the alternative basis of accounts preparation for charities reporting under UK-Ireland Generally Accepted Accounting Practice (GAAP)
offers advice as to what to do if the trustees are unable to prepare accruals accounts on a going concern basis

Matters of material significance reportable to the charity regulators offers advice on those matters that auditors or independent examiners must report to the regulator if they come across them in their review of a charity's accounts.

Charity accounts framework:

England and Wales

Charity reporting and accounting: the essentials November 2016 details the accounting framework by type of charity and it includes advice on working round the 2008 Regulations not being updated for the subsequent SORP

Northern Ireland

Charity reporting and accounting: overall summary

Scotland

A guide to charity accounts

Republic of Ireland

The charity accounting framework remains under discussion and the Charities Regulator has issued a briefing.

Accruals accounts templates (England and Wales):

Non-company charity
Charitable company

Currently no equivalent packs have been issued by the other charity regulators.

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