GUIDANCE FOR ICAS MEMBERS
ACTING FOR CHARITIES IN ENGLAND
AND WALES

AUDIT EXEMPTION: A PRACTICAL GUIDE

PERIODS COMMENCING ON, OR AFTER, 1 JANUARY 2016
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1. INTRODUCTION

1.1 Aim of the guide
The aim of this guide is to support ICAS members acting for charities in England and Wales to understand when a charity client is entitled to audit exemption. It is not a substitute for gaining an understanding of the relevant underlying legislation.

1.2 Scope of the guide
The guide provides an overview of the audit thresholds relevant to charities, including charitable companies, registered with the Charity Commission for England and Wales (the CCEW), covering:

- Audit thresholds: charities receiving an audit under the Charities Act 2011
- Change of legal form and external scrutiny considerations
- ICAS guidance on the audit of charitable companies
- Independent examination
- Cross-border charities: the England and Wales perspective

Excepted charities fall within the scope of the guide. Excepted charities do not need to register with the CCEW. However, they are required to comply with the accounts and scrutiny requirements of charity law. While they are not required to file accounts, they can be requested to do so by the CCEW and they must file an annual report and annual return. Charities can be excepted by order or regulation but will need to register with the CCEW if their annual income in a financial year is more than £100,000.

The guide does not specifically address the external scrutiny requirements which apply to exempt charities. Exempt charities are those exempt from registering with the CCEW. Most exempt charities have their own ‘principal’ regulator. Therefore, the legal requirements which apply to the audit of an exempt charity depend on how the charity is constituted and the regulatory regime under which it operates.

1.3 Audit or independent examination?
Most charities in England and Wales in terms of size will be below the audit threshold. Some charities which are below the audit threshold will receive an audit because their constitution requires one or due to trustee or donor preference. ICAS members acting for charities in this position should encourage the trustees to review on a regular basis whether an audit is the required or is the most appropriate form of scrutiny for the charity. Where funder or donor preference is the only reason for undertaking an audit, charity trustees should be encouraged to engage with funders or donors to establish whether an audit is really necessary to meet their needs.

Charities which do not receive an audit must receive an independent examination under the Charities Act 2011 unless their gross annual income is less than £25,000. The trustees of such charities are still required to prepare annual accounts in
accordance with the charity law and, of course, a charity’s trustees can choose to have its accounts independently examined or audited if they wish.

ICAS member firms undertaking an accounts preparation engagement for a charity should follow our Framework for the preparation of accounts.

1.4 Audit registration

Only accountancy firms which are registered to undertake audit work can audit a charity.
2. AUDIT THRESHOLDS: CHARITIES RECEIVING AN AUDIT UNDER THE CHARITIES ACT 2011

2.1 Overview of most recent changes

For periods ending on, or after, 31 March 2015, the external scrutiny requirements for charities registered with the Charity Commission for England and Wales (the CCEW) and subject to the audit requirements of the Charities Act 2011 were amended to:

- Increase the audit threshold for individual charities from gross annual income of £500,000 to gross income of £1 million.
- Increase the audit threshold for parent charities to the level of the revised group accounts preparation threshold.

The group accounts preparation threshold for parent charities increased at the same time from gross annual income of £500,000 to gross annual income of £1 million. Gross income for this threshold is based on income after consolidation adjustments. There has been no change to the requirement that a charity with gross assets of more than £3.26 million which also has gross annual income of more than £250,000 must receive an audit.

For an individual charitable company above the audit threshold in the Companies Act 2006, the Charities Act 2011 audit requirements do not apply. Information on the Companies Act audit threshold for periods commencing on or after 1 January 2016 is available here.

For a charitable company parent above the Companies Act 2006 group accounts’ preparation and audit thresholds, the Charities Act 2011 audit requirements do not apply.
2.2 Summary of Charities Act 2011 audit thresholds

| Charity audit threshold for periods ending on, or after, 31 March 2015 |
| For a charity registered with the CCEW and complying with Charities Act 2011, the audit threshold is: |
| - gross annual income greater than £1 million; or |
| - gross assets of more than £3.26 million and a gross annual income of more than £250,000. |

| Audit threshold for a charitable group for periods ending on, or after, 31 March 2015 |
| For a parent charity registered with the CCEW and complying with the Charities Act 2011, the audit threshold is: |
| - gross income of the group greater than £1 million after consolidation adjustments. |

Other considerations
In addition, a charity will need an audit if:
- it is required to by the constitution of the charity, any other enactment, or on the instruction of its trustees
- in the case of a charity with a pre-1992 constitution, that constitution contains a requirement for an audit or examination by a professional auditor

If a charity is a company or a parent company above the Companies Act 2006 audit threshold, an audit should be undertaken solely under company law.

2.3 Interpretation of the term audit for constitutions approved before the Charities Act 1992

If a charity’s constitution was approved before the Charities Act 1992, then ‘audit’ may be interpreted by the trustees to mean ‘the appropriate external scrutiny required by the current legislation’. In this case a charity can have an independent examination if its gross annual income is below the current audit threshold even if its constitution refers to an ‘audit’ being required. In other words, if the constitution only refers to a requirement for an audit, without stipulating that the ‘audit’ has to be performed by a professional auditor, then an independent examination will meet the requirement.

However, if the constitution clearly states or stipulates that a professional auditor must carry out an examination or audit, such a charity will need to have an audit, or amend its constitution. Unless the trustees have the power to amend the constitution, the trustees will need CCEW approval to make the change.

2.4 Audit of receipts and payments accounts: Non-company charities only

Charities eligible to prepare receipts and payments accounts may need an audit if the constitution of the charity, another enactment, or the trustees or its funders or donors require one. Receipts and payments accounts are not required to give a “true and fair” view therefore the auditor will be required to give an opinion on whether the accounts properly present the receipts and payments of the charity for the financial year and the assets and liabilities of the charity reported in the statement of balances.
3. CHANGE OF LEGAL FORM AND EXTERNAL SCRUTINY CONSIDERATIONS

3.1 Introduction

Where a charity changes its legal form, for example when an unincorporated association becomes a charitable incorporated organisation (CIO) or a charitable company, this may be considered a group reconstruction.

The method of accounting used for a change in legal form may impact on the successor charity’s gross annual income in its first year. There are also differences in the accounting methods available for accounts prepared under FRS 102 and accounts prepared on a receipts and payments basis.

In this guide we consider the options available under FRS 102 and the impact this could have on the external scrutiny requirements of the successor charity.

3.2 Issues for a successor charity applying FRS 102

FRS 102 permits a group reconstruction to be accounted for using acquisition accounting and permits merger accounting to be used if certain criteria are met. The Charities Statement of Recommended Practice (FRS 102) (the Charities SORP (FRS 102)) interprets the criteria for merger accounting for charities.

If acquisition accounting is used the fair value of the net assets or liabilities of the predecessor charity must be recorded in the Statement of Financial Activities of the successor charity. Where the successor charity’s accounts record the fair value of net assets as income, this may result in a one off increase in gross annual income significant enough for the successor charity to exceed the audit threshold even if an independent examination was undertaken previously.

Should the audit threshold applying to the legal form of the successor charity be exceeded in year one of its existence, the charity’s trustees can apply to the CCEW for dispensation from having an audit. Applications for dispensation are made under Regulation 34 of the Charities (Accounts and Reports) Regulations 2008.

Where merger accounting is applied two scenarios are likely:

• Scenario one. The change of legal form is merely dealt with through narrative disclosure meaning that the change of legal form has no impact on the gross annual income of the charity.
• Scenario two. The change of legal form coincides with end of the predecessor charity’s financial year meaning that the opening balance sheet of the successor charity reflects the carrying value of the predecessor charity’s assets and liabilities. As with the first scenario, the change in legal form has no impact on the gross annual income of the charity.

3.3 Cessation accounts: issues for a predecessor charity

If acquisition accounting is used or merger accounting is used in the circumstances described in scenario two, the predecessor charity would normally prepare cessation accounts. The accounts should receive the appropriate level of scrutiny as determined by the legal requirements pertaining to the legal form of the predecessor charity, unless dispensation has been applied for and awarded by the CCEW.
There is no explicit requirement for cessation accounts to be prepared and filed in the Charities Act 2011 and the Charities (Accounts and Reports) Regulations 2008. However, a charity would normally be required to prepare accounts for any accounting period it was in existence. The CCEW also operates a practice of requiring charities to include a requirement for cessation accounts in their constitution. Therefore, an ICAS member acting for a charity changing its legal form should check the predecessor charity’s constitution for any requirement to prepare cessation accounts.
4. ICAS GUIDANCE ON THE AUDIT OF CHARITABLE COMPANIES

4.1 FRC and CCEW view

The Financial Reporting Council (FRC) and the CCEW take the view that a charitable company (either standalone or a parent not required to prepare group accounts), which is below the company law audit threshold but above the charity law audit threshold, can receive an audit solely under charity law and elect for audit exemption under company law.

4.2 The ICAS view

ICAS, however, takes the view that it is good practice where any piece of legislation requires a charity to be audited that the charity is audited under all applicable legislation. Therefore, our guidance to members on the legislative basis for the audit of charitable companies is as follows:

- For an individual charitable company below the company audit threshold but above the Charities Act 2011 audit threshold, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006.
- For an individual charitable company above the company law audit threshold, an audit should be undertaken under the Companies Act 2006.
- For an individual charitable company below the Charities Act 2011 audit threshold, strictly speaking an audit should be undertaken under the Companies Act 2006. However, practice is for auditors to undertake the audit under both the Charities Act 2011 and the Companies Act 2006, indicating a grey area in the legal requirements.
- For a parent charitable company preparing group accounts, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006, unless the charitable parent heads a group which exceeds the Companies Act threshold for preparing group accounts in which case the audit should be undertaken solely under the Companies Act 2006.

The rationale for ICAS guidance in respect of the legislative bases of audit is that:

- A charitable company receiving an audit should always be audited under the Companies Act 2006.
- A charitable company should not receive an audit under the Charities Act 2011 unless specifically required to do so under that Act. The exception to this is the practice followed by auditors of charitable companies below the Charities Act 2011 audit threshold where the applicability or otherwise of the 2011 Act’s audit requirements is not clear.

If a decision is taken to audit a charitable company solely under charity law, the audit firm should check with its professional indemnity insurance provider to discuss any implications for its insurance cover.
### 4.3 Summary of legislative basis for accounts and audit requirements of charitable companies

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<th>Size of company</th>
<th>Individual charitable company</th>
<th>Charitable parent company preparing group accounts</th>
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<td>Accounts preparation</td>
<td>Audit</td>
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<td></td>
<td>Accounts preparation</td>
<td>Audit</td>
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5. INDEPENDENT EXAMINATION

5.1 Introduction

A charity registered with the CCEW which does not receive an audit requires an independent examination under the Charities Act 2011 unless its gross income is below £25,000. Prior to undertaking an independent examination rather than an audit, it is vital to check that the charity is entitled to audit exemption under the law and does not otherwise require an audit.

An ICAS member can undertake:

- the independent examination of receipts and payments accounts; and
- the independent examination of true and fair accounts prepared in accordance with the Charities Statement of Recommended Practice (the Charities SORP).

An independent examination can be undertaken as a voluntary assignment by an ICAS member who does not have a practising certificate. Accountancy firms also take on independent examination engagements.

ICAS limits the number of charity engagements a member can undertake without a practising certificate to 10. Further information about this is available here.

5.2 CCEW guidance and requirements for independent examiners

CCEW guidance CC32 Independent examination of charity accounts, examiners’ guide contains both requirements and good practice guidance for independent examiners. It covers the CCEW’s Directions to independent examiners which must be followed. The Directions are a framework defining how an independent examiner must meet their reporting duties and apply to both the examination of true and fair accounts and receipts and payments accounts.

CC32 was last updated in June 2015. A further update is underway and publication is expected in mid-2017.
6. CROSS-BORDER CHARITIES: THE ENGLAND AND WALES PERSPECTIVE

6.1 What is a cross-border charity?

A cross-border charity, for the purposes of this guide, is a charity registered with the CCEW which also has registration and/or filing requirements placed on it by the charity law of another UK jurisdiction.

At present a CCEW registered charity may be required to register with the Office of the Scottish Charity Regulator (OSCR) under the Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act (Scotland)).

In the future, a CCEW registered charity may be required to register with the Charity Commission for Northern Ireland (the CCNI) under the Charities (Northern Ireland) Act 2008 (the 2008 Act (Northern Ireland)) and otherwise provide details of its activities in Northern Ireland.

6.2 Compliance with charity law in Scotland

There is guidance available on the OSCR website about the requirements placed on cross-border charities. The guidance is tailored for charities established in England & Wales.

Where a charity is registered with the CCEW and with OSCR it must comply with both the 2005 Act (Scotland) and regulations made thereunder, including the Charities Accounts (Scotland) Regulations 2006 (as amended), in addition to complying with the requirements of the Charities Act 2011 and regulations made thereunder, including the Charities (Accounts and Reports) Regulations 2008 where relevant.

Any charity registered in Scotland with OSCR must receive an independent examination if it does not receive an audit: the independent examination should be conducted under both the 2005 Act (Scotland) and the Charities Act 2011.

6.3 Summary of audit thresholds for cross-border charities registered with OSCR

<table>
<thead>
<tr>
<th>Audit threshold for a cross-border charity registered with OSCR</th>
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<tr>
<td>• gross annual income of £500,000 or more; or</td>
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<tr>
<td>• gross assets of more than £3.26 million at the balance sheet date.</td>
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<th>Audit threshold for a cross-border charitable parent registered with OSCR</th>
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<tr>
<td>• gross annual income of the group £500,000 or more after consolidation adjustments.</td>
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<table>
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<th>Other considerations</th>
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<tr>
<td>If a cross-border charity is registered with OSCR the strictest thresholds apply. In addition, a charity will need an audit if:</td>
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<tr>
<td>• it is required to by the constitution of the charity, any other enactment, or on the instruction of its trustees.</td>
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6.4 Compliance with charity law in Northern Ireland

Section 167 of the 2008 Act (Northern Ireland), provides for the Department for Communities to issue orders, which must be approved by the Northern Ireland Assembly, or regulations pertaining to institutions which are not charities under the law of Northern Ireland but which operate for charitable purposes in or from Northern Ireland. Such an institution is known as a ‘section 167 charity’.

In the future a section 167 charity will be expected to prepare for each financial year; a financial statement; and a statement of activities, relating to its operations in or from Northern Ireland in a form determined in regulations issued by the Department for Communities.

The Department also has the power to issue an order requiring the CCNI to maintain a register of section 167 charities.

Any charity registered with the CCEW that believes it may fall within the definition of section 167 charity can contact the CCNI directly with any queries by emailing: registration@charitycommissionni.org.uk