

understanding reports on charity financial statements

A CIPFA charities panel guide

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CIPFA Charities Panel

To find out more about the CIPFA Charities Panel go to:
<http://www.cipfa.org.uk/panels/charity/about.cfm>

\ introduction

This is the first in a series of short guides produced by the CIPFA Charities Panel. The series seeks to provide accountants and non-accountants with information aimed at improving their understanding of charity accounting and reporting and highlighting areas of interest to those involved in the civil society and public service spheres.

This guide provides a brief overview of the main forms of external reports produced on charity financial statements. The purpose is to provide non-accountants with a basic understanding of the differing types of assurance provided and the type of content included in an unqualified report.

Qualified and unqualified reports

The terms 'qualified' and 'unqualified' can seem confusing when applied to reports on financial statements. A 'qualified report' may sound as if it is the more favourable of the two types of report when in fact it indicates that certain matters of concern need to be drawn to the attention of the reader.

An unqualified report is one that does not contain any qualifying remarks. It gives the reader some confidence that nothing significantly untoward has been identified. Whereas a qualified report draws the reader's attention to a matter of concern that may affect how they view the charity's financial statements.

A qualified audit report, for example, would be one where qualifying remarks are included which place conditions on the extent to which the financial statements can be said to represent a true and fair view. A qualification could, for example, address an infringement of accounting standards. If the issues are of a particularly serious nature the auditor may give an adverse opinion.

An unqualified independent examiner's report confirms that the examiner has come across no evidence which would lead them to not to be able to state that sufficient accounting records have been kept, the accounts comply with the applicable regulations, or to require them to advise that they found expenditure contrary to the charity's trust or necessary information was with-held.

This guide will help readers of financial statements identify:

- the level of assurance provided by the report
- the elements found within a report and
- items to consider when reading the report.

It is hoped this will be of value to funders, commissioners and other readers of the financial statements and annual reports of charities. We gratefully acknowledge the contributions of CIPFA Charities Panel members in compiling and editing this guide.

types of charity financial statements

There are two types of charity financial statements:

- Financial statements prepared on an accruals basis
- Receipts and payments accounts

Accounts prepared on an accruals basis

The accruals concept requires the effects of transactions to be reflected as far as possible for the period in which they occur, which is not necessarily the period in which cash is received or paid. An example is reporting the cost of electricity **consumed** during the financial year which can differ from electricity **paid for** during the financial year.

The *Statement of Recommended Practice: Accounting and Reporting for Charities* (SORP) sets out recommended practice for preparing the Trustee's Annual Report and the accounts of a charity on an accruals accounts basis. Financial statements prepared in accordance with the Charity SORP normally include:

- a statement of financial activities (SOFA) which shows the results of operations and activities for the year,
- a balance sheet, which shows assets, liabilities and funds held at year end,
- a cash flow statement (not required for small charities) which provides an analysis of cash movements,
- notes to financial statements, which are an integral part of financial statements, providing additional explanations and details on financial statement items.

Accounts should be prepared in line with accounting policies adopted by the charity, which enable the accounts to give a true and fair view and are consistent with accounting standards and the accounting concepts of accruals and going concern.

Receipts and payments accounts

Receipts and payments accounts are based on cash accounting rather than accrual accounting. Smaller charities¹ which are not registered companies can opt to prepare accounts on a receipts and payments basis. They provide a summary of money transactions during the year (money received and money paid) as well as information on the charity's assets and liabilities at year end. Financial statements prepared on a receipts and payments basis normally include:

- a receipts and payments account
- a statement of assets and liabilities (in Scotland this is called a statement of balances)

Preparation of financial statements

It is the trustee's responsibility to ensure financial statements are produced. Management may be delegated to carry this out. In some cases, charities without financial expertise may engage the services of others outside of the organisation, including qualified accountants, to prepare financial statements on their behalf.

¹ Unincorporated charities in England and Wales with gross income below £250,000 (for accounts from 1 April 2009); in Scotland it is unincorporated charities with gross income below £100,000, although from 1 April 2011 this threshold will change to £250,000.

types of report on charity financial statements

Reports on the financial statements will indicate the type and degree of work done and the level of assurance provided by the report in respect of the financial statements. Reports produced on charity accounts fall in to three types:

- Audit
- Independent Examination
- Accountant's Report (no longer accepted for accounts starting on or after 1st April 2008 – see page 6)

Audit

Audit engagements require the auditor to: assess the accounting and internal control systems, perform detailed tests of control and substantive procedures, to corroborate explanations received and to consider if the information provided in the financial statements gives a 'true and fair' view. Audits provide a reasonable level of positive assurance. An auditor is required to conduct their audit so as to be able to identify any material misstatement due to fraud or error.

The audit report includes an opinion on whether the financial statements provide a 'true and fair' view. The level of assurance provided by an audit engagement is underpinned by the requirement for auditors reporting in 'true and fair' terms to abide by all of the Statements of Auditing Standards and *Audit Practice Note 11: the audit of charities in the UK* issued by the Auditing Practices Board.

Only chartered accountants who have an audit practising certificate can carry out a statutory audit of financial statements in the UK. The auditor must be a member of a recognised supervisory body and hold a recognised professional qualification. The recognised supervisory bodies are:

- The Association of Chartered Certified Accountants (ACCA)
- The Institute of Chartered Accountants in England and Wales (ICAEW)

- The Institute of Chartered Accountants of Scotland (ICAS)
- The Institute of Chartered Accountants in Ireland (ICAI)
- Association of Authorised Public Accountants (AAPA)*
- Charity regulators may also approve the appointment of CIPFA qualified auditors to Local Authority or NHS managed charities

*The AAPA is a subsidiary of ACCA

Independent Examination

The Independent Examination is specific to charities. Some non-charity voluntary and community organisations adopt an Independent Examination although in those cases it will not have the same legal or regulatory authority as a charity independent examination.

It is an external review of a charity's accounts and can be carried out by any person with the requisite ability and practical experience, except where the gross income exceeds £250,000 or, in the case of Scotland, when accruals accounts are prepared. In England and Wales the examiner must be a member of a prescribed body² if the income of the charity exceeds £250,000. In Scotland, when accruals accounts are prepared the examiner must always be a qualified accountant.

² Details of prescribed bodies are on page 14

In England and Wales the examiner is only required to provide a statement on specific matters that have come to their attention as a result of the examination procedures specified in the Directions made by the Commission. In Scotland, the examiner is required to provide certain statements in accordance with the Charities Accounts (Scotland) Regulations 2006 (as amended). The Office of the Scottish Charity Regulator (OSCR) does not issue Directions that must be followed by an independent examiner.

Although an examination is a less onerous form of scrutiny than an audit and provides less assurance in terms of the depth of work required to be carried out, the regulations require an examiner to follow a structured approach and report on several specific matters. It is a simpler form of scrutiny than an audit but it provides an assurance that the accounts of the charity have been reviewed by an independent person.

Accountant's report

An accountant's report (also referred to as an 'accountant's compilation report') is no longer acceptable for a charity for financial years beginning on or after 1 April 2008. The use of this report is restricted to company charities (also known as charitable companies) reporting for accounting periods beginning prior to 1 April 2008. The use of an accountant's report for periods after 1 April 2008 indicates non-compliance by the trustees and/or the accountant with the legal requirements of charity and company law.

An accountant's report may have been produced when an accountant had not carried out an audit or independent examination but had prepared the accounts. The report makes clear that the work has been undertaken by the accountant, indicates the professional requirements s/he has to fulfil and the standard to which the work has been carried out, as well as, if considered appropriate, underlining the respective responsibilities of the trustees and the practitioner.

The level of independence associated with an audit or independent examination is not required for an accountants report, provided that no assurance services are provided and any relevant relationships and conflicts of interest are disclosed.

Because the accountant's report is no longer acceptable we have not included an example in this guide.

audit - example of unqualified report

Below is an example of an unqualified audit report for a charity that is registered with the Charity Commission and OSCR. Elements of the report are discussed on page 9.

Independent Auditor's report to the Trustees of XYZ Charity (1)

We have audited the group and parent charity financial statements of XYZ for the year ended (day, month, year) which comprises the Statement of Financial Activities, the Charity Balance Sheet, the Cash Flow Statement and the related notes. The financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of trustees and auditors (2)

The responsibilities of the trustees for preparing the Trustees' Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Trustees' Responsibilities.

We have been appointed as auditors under section 43 of the Charities Act 1993 and under section 44 (1) (c) of the Charities and Trustee Investment (Scotland) Act 2005 and report in accordance with regulations made under those Acts. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the charity's trustees as a body in accordance with paragraph 30 of The Charities (Accounts and Reports) Regulations 2008 made under Part VI, the Charities Act 1993, section 44 (1) (c) of the Charities and Trustee Investment (Scotland) Act 2005 and Regulation 10 of the Charities Accounts (Scotland) Regulations 2006 (as amended) and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly

agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Charities Act 1993, the Charities and Trustee Investment (Scotland) Act 2005 and Regulation 8 of the Charities Accounts (Scotland) Regulations 2006 (as amended). We also report to you if, in our opinion, the information given in the Trustees' Annual Report is not consistent with those financial statements, if the charity has not kept proper accounting records, if the charity's financial statements are not in agreement with these accounting records or if we have not received all the information and explanations we require for our audit.

We read the Trustees' Annual Report, and consider the implications for our report if we become aware of any apparent misstatements within.

Basis of audit opinion (3)

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (4). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements (5). It also includes an assessment of the significant estimates and judgements made by the trustees in the preparation of the financial statements, and of whether the accounting policies are appropriate to the charity's circumstances, consistently applied and adequately disclosed (6).

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused

by fraud or other irregularity or error (7). In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion (8)

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the charity's affairs as at (day, month, year), and of the charity's incoming resources and application of resources including the charity's cash flows, for the year then ended; and
- the financial statements have been properly prepared in accordance with the Charities Act 1993, the Charities and Trustee Investment (Scotland) Act 2005 and Regulation 8 of the Charities Accounts (Scotland) Regulations 2006 (as amended).

Chartered accountant (9)

Date (10)

audit – explanation of elements found in report

1. Auditor's report to the charity trustees

The auditor's report is addressed to the trustees because that is the group to whom the auditor is responsible in carrying out a charity audit. Depending on the charity's legal structure and wording of the charity's governing document the auditor may refer to the trustees as the trustees or the board of directors or the management committee.

The financial statements being reported on are identified in order to avoid confusion over the period or type of accounts being discussed. The date quoted is the charity's financial year end.

2. Respective responsibilities of trustees and auditors

The respective responsibilities of the auditor and the trustees are set out. Note that even where the accounting organisation may have compiled the accounts, the responsibility for producing the year end accounts and/or annual report remains with the trustees and not the accountant or auditor.

The regulations and Acts quoted in this section of the report will depend on which parts of the UK the charity operates in. It will of course change as legislation and regulation changes.

Note that the trustee's annual report is also reviewed as part of the audit process. This is to consider if there is any mismatch between what is said in the financial statements and what is stated in the annual report content.

3. Basis of audit opinion

A description of the scope of the audit is included.

4. Auditing standards

These standards require the auditor to have the required training, skills and experience to carry out an audit. This includes the requirements for the

audit to be planned and performed objectively and with due care. Audit evidence is built up through the audit process and will include: inspection, observation, enquiry, confirmation, computation and analysis. These standards are developed by the Auditing Practices Board. See their website for more information:

<http://www.frc.org.uk/apb/index.cfm>

5. On a test basis

An audit does not include verification of all of the charity's transactions for the accounting period. As part of the audit process the auditor will judge the nature, extent and timing of tests of transactions. This will include, for example deciding on the range and extent of a sample of transactions to look at and the supporting documentary evidence to be viewed and verified.

6. Assessing and evaluating

The audit will consider the charity management's application of Generally Accepted Accounting Practice (GAAP) including *Accounting and Reporting by Charities: Statement of Recommended Practice (SORP)*. This will include assessment of the application of accounting principles and the presentation of the financial statements.

7. Information presented fairly in all material respects

Information in financial statements will include estimates and judgements, albeit that the goal is to present the financial information fairly. Estimates and disclosures will not necessarily be exact and subject to some difference of opinion and the auditor will be concerned with whether such differences materially mislead readers or not. Materiality is an important component of this assessment.

8. Opinion

The auditor provides an opinion on the financial statements based on their assessment of the charity's internal controls, those elements of the charity's accounting records that were examined (on a test basis) and other supporting evidence. As such it is an opinion formed which is based on the audit work undertaken and not an assertion of fact.

Any significant item that has not been properly treated or disclosed on a consistent basis in accordance with GAAP must be mentioned in the audit report as a qualification of the opinion.

9. Chartered accountant

As mentioned earlier, the auditor must be a member of a recognised supervisory body and hold a recognised professional qualification. See page 5 for a list of recognised bodies.

10. Date

This date draws a line in terms of the date up to which the auditor would have gathered evidence in support of the opinion provided in the audit report.

independent examination - example of unqualified report

Example of unqualified report for a company charity registered with the Charity Commission and OSCR. Elements of the report are discussed on page 13.

Independent examiner's report to the trustees of XYZ (1)

I report on the accounts of the company for the year ended (day, month, year), which are set out on pages 00 to 00.

Respective responsibilities of trustees and examiner (2)

The trustees (who are also directors of the company for the purposes of company law) are responsible for the preparation of the accounts. The trustees consider that an audit is not required for this year under section 43(2) of the Charities Act 1993 (the 1993 Act) or under regulation 10 (1) (a) to (c) of The Charities Accounts (Scotland) Regulations 2006 (as amended) (the 2006 Accounts Regulations) and that an independent examination is needed. The charity is required by company law to prepare accrued accounts and I am qualified to undertake the examination by being a qualified member of (named body).

Having satisfied myself that the charity is not subject to audit under company law and is eligible for independent examination, it is my responsibility to:

- examine the accounts (under section 43(3)(a) of the 1993 Act) and section 44(1)(c) of the Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act);
- follow the procedures laid down in the general directions given by the Charity Commission (under section 43(7)(b) of the 1993 Act); and

- to state whether particular matters have come to my attention.

Basis of independent examiner's report (3)

My examination was carried out in accordance with the general directions given by the Charity Commission and is in accordance with Regulation 11 of the 2006 Accounts Regulations. An examination includes a review of the accounting records kept by the charity and a comparison of the accounts presented with those records. It also includes consideration of any unusual items or disclosures in the accounts, and seeking explanations from you as trustees concerning any such matters. The procedures undertaken do not provide all the evidence that would be required in an audit, and consequently no opinion is given as to whether the accounts present a 'true and fair view' and the report is limited to those matters set out in the statement below.

Independent examiner's statement (4)

In connection with my examination, no matter has come to my attention:

1. which gives me reasonable cause to believe that in any material respect the requirements:
 - to keep accounting records in accordance with section 386 of the Companies Act 2006 and section 44(1)(a) of the 2005 Act; and
 - to prepare accounts which accord with the accounting records,

- comply with the accounting requirements of the Companies Act 2006, section 44(1)(b) of the 2005 Act and regulation 8 of the 2006 Accounts Regulations; and
 - which are consistent with the methods and principles of the Statement of Recommended Practice: Accounting and Reporting by Charities have not been met; or
2. to which, in my opinion, attention should be drawn in order to enable a proper understanding of the accounts to be reached.

Date:

Name:

**Relevant professional qualification
or body (5)**

Address

independent examination - explanation of elements found in report

1. Report to the charity trustees

The report is addressed to the charity trustees because that is the group to whom the examiner is responsible to in carrying out the independent examination.

2. Respective responsibilities

This section clarifies the responsibilities of trustees and the independent examiner. It makes clear that the trustees: a) are responsible for preparation of the accounts, b) take the view that an audit is not required and c) take the view that an independent examination is needed.

The examiner: notes the accounting basis of the financial statements (i.e. accrual or receipts and payments) and indicates that they are qualified to carry out an examination of that type of accounts. This can include reference to their accounting body membership. The examiner also states their responsibilities to: a) examine the accounts under the relevant legislation, b) carry out the examination in line with Charity Commission directions (where applicable to the jurisdiction) and c) state whether particular matters have come to their attention.

3. Basis of report

This clarifies the scope of work undertaken by the examiner and includes:

- A review of the accounting records
- A comparison of these to the financial statements produced
- Consideration of any unusual items or disclosures in the financial statements
- A statement that the procedures undertaken do not provide all of the evidence that an audit requires, and that consequently an opinion cannot be given in respect of whether they represent a true or fair view.

4. Examiner's statement

The examiner is only required to provide a statement on specific matters that have come to their attention as a result of the procedures set out in the Directions produced by the Charity Commission. This is a simpler requirement than that of an audit. An auditor must compile evidence in support of a statement of opinion including whether the accounts present a 'true and fair view'.

However the Charity Commission's ten Directions do address a number of important areas and cover: examination and accounting thresholds, documentation, understanding the charity, accounting records, comparison with accounting records, analytical procedures, form and content of accounts, accounting policies, estimates and judgements and trustee's annual report. There is also a statutory duty to report certain matters of material significance to the Charity Commission.

In Scotland, OSCR does not issue Directions for independent examination; instead, the examiner must report on certain matters in accordance with the Charities Accounts (Scotland) Regulations 2006 (as amended). There is also a statutory duty to report matters of material significance to OSCR.

5. Relevant professional qualification or body

The Charity Commission recommends that the examiner be a qualified accountant or an individual with similar qualifications in charity finance at an appropriate level. There are tighter rules regarding who can examine charities above a certain threshold. In England and Wales the threshold is where charity income exceeds £250,000. In Scotland the criteria is in respect of any charity that produces fully accrued accounts and other charities with income above £100,000, rising to £250,000 for accounting periods starting on or after 1 April 2011. Further clarification should be sought from the national charity regulator.

Independent examiners – prescribed lists

Persons allowed to examine accounts over the particular threshold are limited to those who meet the regulators prescribed list criteria. The prescribed list for England and Wales requires the examiner to be a member of one of the following bodies and must also be allowed by that body to undertake independent examinations:

- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants of Scotland
- The Institute of Chartered Accountants in Ireland
- The Association of Chartered Certified Accountants
- The Association of Authorised Public Accountants
- The Association of Accounting Technicians
- The Association of International Accountants
- The Chartered Institute of Management Accountants
- The Institute of Chartered Secretaries and Administrators
- The Chartered Institute of Public Finance and Accountancy
- A Fellow of the Association of Charity Independent Examiners

The prescribed list for Scotland is slightly different from that above. Instead of a Fellow of the Association of Charity Independent Examiners, the requirement in Scotland is for a Full Member of that body. In addition, in Scotland, the prescribed list also includes the following:

- a person appointed by the Accounts Commission for Scotland, or
- the Auditor General for Scotland

CIPFA and the charities panel

CIPFA is the leading professional accountancy body for public services, whether in the public or private sectors. We provide education and training in accountancy, financial management and audit, and set and monitor professional standards. Our professional qualification is high-quality, relevant and practical, and is supported by a range of other products and services. We are a major publisher of guidance for practitioners and others with an interest in the public services.

CIPFA Charities Panel is composed of members from a cross-section of charities and organisations working with charities including the Charity Commission, the Office of the Scottish Charity Regulator and accountancy practitioners. For further information on the Panel visit the CIPFA website www.cipfa.org.uk or contact Matthew Allen matthew.allen@cipfa.org.uk or John Maddocks john.maddocks@cipfa.org.uk



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