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Preparing Charity Accounts

Fifth Edition

Anthony Epton





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Foreword

Anthony has dedicated this book to Adrian Randall, his managing partner when Anthony was in the first part of his professional career and the mentor who persuaded a then somewhat hesitant Anthony to study under me for a postgraduate qualification in Charity Finance. It is a true testament to Adrian's vision that Anthony has written this authoritative book.

Adrian Randall will in future years be regarded by students and thoughtful practitioners as not only one of the founders of Charity Finance but the father of the subject in the same way that Frederick Winslow Taylor is for management. Adrian was first and foremost a practitioner not an academic. He had a genuine thirst for knowledge best exemplified in that after qualifying as a Chartered Accountant, he went on to University and read a degree in Economics. Adrian's career was then in the commercial world but in his forties he faced a decision to take a finance director's job with another commercial company or join a charity. For the benefit of all in Charities he chose the latter and became Finance Director of what was is now Cancer UK.

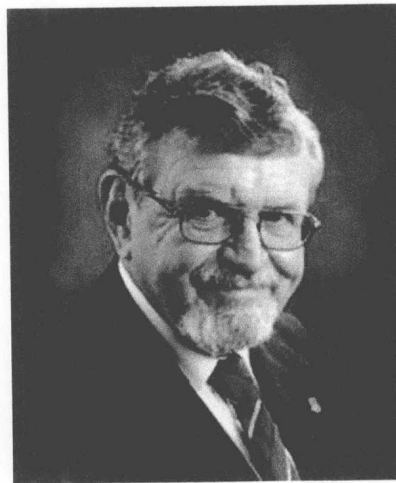
I first met Adrian in early 1990 when I was researching for my Doctorate and he had co-founded with Andrew Hind the organisation we know to-day as the Charity Finance Group. He believed that the only way Charity Finance was to emerge as both a practice and distinctive area in its own right and not be a 'backwater' in the accounting profession was if a distinct body of academic knowledge could be developed and quickly realised that a first step would be a University course from which its advocates would emerge. Without Adrian and the then Charity Finance Directors Group support I would not have been able to develop the first postgraduate course in Charity Finance. Adrian was appointed Visiting Professor and ensured that the bright young people both in practice and working in charities were engaged with the material - including the then very young Pesh Framjee and Neil Finlayson! Later when I moved universities and started a new degree programme Adrian was there ensuring nothing less than the very best would be involved in the degree. He then entered into negotiations with the Institute of Chartered Accountants in England and Wales to create the Diploma in Charity Accounting qualification.

Adrian moved back to the land of his birth, Barbados, and took up the Chief Executive role with their Heart Foundation. He maintained contact throughout and shared with me a vision to eventually create an international qualification. I am sure this would have been achieved by now if not for his early and tragic death.

Anthony's book is then not just another 'how to' book. It is instead a tribute to a man who was a professional, a critical practitioner and visionary. Anthony has written a book that Adrian would be justly proud of, having all the ingredients that he was about. It is a book that he himself would, I am sure, have been proud to have written. That it has been produced by Anthony who exemplifies many of the hopes and aspirations that Adrian had for the next leading generation shows that his vision is being carried forward.

Paul Palmer
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London

Adrian Randall (1944 - 2012)



The Fifth Edition of Preparing Charity Accounts is dedicated to the memory of Adrian Randall. Not only was Adrian the inspiration behind the previous four editions but he was also the driving force behind upgrading and regulating charity accounting in the UK. Adrian co-founded what is now called the Charity Finance Group and chaired it for its first four years until 1992 when he became chair of the Charities Tax Reform Group (now Charity Tax Group).

Despite being a nationally recognised expert in all areas of charity finance, Adrian still personified great humility and a personal touch in all his dealings. He was a giant amongst men, epitomising great intellectual skills while still possessing the common touch. He is sorely missed but remembered with great affection and admiration.

Preface and acknowledgements

In 1999, the first edition of *Preparing Charity Accounts* was written to provide help, advice and information for all those involved in preparing charity accounts, whether as an accountant, auditor or treasurer. It was based on the collective experiences of Adrian Randall, Fiona Young and me in advising charities on how to comply with the Charities Statement of Recommended Practice (SORP) *Accounting by charities* published in October 1995. Since then, three further editions were published, co-written by the three of us. Adrian, to whom this book is dedicated, sadly passed away in March 2012 and Fiona, at the other end of the life cycle, is now looking after her young daughter. I have therefore taken over the responsibility of writing this fifth edition myself.

In the two years following the publication of the first edition there were quite a few changes in the charity accounting world particularly the publication in October 2000 of a revised Charities SORP *Accounting and reporting by charities* and the subsequently updated Regulations. The second edition (2001) was therefore an update of that first edition, which sought to look, at in some detail, the changes that had occurred. The revised table of contents was not significantly different from that of the original 1999 publication and the book was laid out in four parts, as was the previous version. However one new feature in the second edition was the inclusion of examples taken from CC66 *Example reports and accounts* which was first published in 2000.

Further changes over the next four years occurred with another updating of the SORP (*Accounting and reporting by charities statement of recommended practice 2005*) and the *Charities (Accounts and Reports) Regulations 2005* for England and Wales. Then, north of the border, there was the *Charities and Trustee Investment (Scotland) Act 2005* followed by the *Charity Accounting Regulations (Scotland) 2006* (now 2010).

Given the significant changes in both the 2005 SORP and the Regulations, it was felt that a third edition was necessary. The third edition was, however, kept to the tried and trusted formula of the first two editions in the layout of that third edition of the book. It was hoped that this made it an easy read especially for those who made such great use of both the first and second editions.

Since 2005 although no 'new' SORP has emerged there have been a considerable number of changes, not all of them improvements, that have impinged upon charity accounts. The Charity Commission published early in 2008 an updated version of the 2005 SORP and the publishers felt that it was an appropriate time to produce a fourth edition which was then duly written. This fourth edition was therefore brought up to date to include all the relevant changes and a greater set of 'real-life' examples from published charities' accounts.

However as always with a book like this there is an ever-changing scene. Since May 2008, when the fourth edition was published, the following developments have taken place:

- *Charities Act (Northern Ireland) 2008* – September 2008
- *The Charities Acts 1992 and 1993 (Substitution of Sums) Order 2009* – April 2009
- *The Charities Accounts (Scotland) Amendment Regulations 2010* - July 2010
- *FRED 46 Application of Financial Reporting Requirements* – January 2012
- *FRED 47 Reduced Disclosure Framework* – January 2012
- *FRED 48 The Financial Reporting Standard applicable in the UK and Republic of Ireland* – January 2012

Preface and acknowledgements

- APB Practice Note 11 *The audit of charities* (Revised) – March 2012 including the introduction of clarified ISAs (UK and Ireland) that became effective for accounting periods ending on or after 15 December 2010
- APB Bulletin 2010/2 (Revised) – March 2012
- *Charities Act* 2011 – March 2012

Due to the significant number of changes since the fourth edition was published, this fifth edition has now been written. Going forward, there are still several crucial issues to be resolved:

- how charity accounting is going to be shaped in relation to international financial reporting standards;
- the new re-written online modular charities SORP;
- the nature of public benefit in relation especially to fee-charging charities; and
- the implementation of Lord Hodgson's recommendations following his review of the *Charities Act* 2006.

No doubt, all good material for even more editions of this popular book!

I would like to thank all those charities who have allowed examples from their accounts to be used to illustrate particular points. Additionally I would like to thank Anastasiya Nikolova for her help with the proof reading and very importantly my dear wife Lara for all her ongoing support.

I believe that *Preparing Charity Accounts* is an essential reference work for anyone responsible for producing or monitoring the accounts of charity. As a one-stop guide it provides clear, relevant commentary and guidance and like its predecessors is full of practical worked examples.

Anthony Epton BA, FCA, CTA, FCIE
October 2012

Abbreviations

APB	Auditing Practices Board
ASB	Accounting Standards Board
CFG	Charity Finance Group
ED	Exposure Draft
FRED	Financial Reporting Exposure Draft
FRS	Financial Reporting Standard
FRSSE	Financial Reporting Standard for Smaller Entities
s.	section
ISA	International Standards on Auditing
Sch.	Schedule
SOFA	Statement of financial activities
SORP	Statement of Recommended Practice
SSAP	Statement of Standard Accounting Practice
UITF	Urgent Issues Task Force

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Part I Scene setting and background to the industry

Chapter 1 Introduction

It is quite clear that by definition not all voluntary or non-profit making organisations are charities. Tax legislation defines a charity as 'any body of persons or trust established for charitable purposes only', but does not define charitable purposes. To find out what are considered 'charitable purposes' one has to go back to an Act of 1601 and a line of court decisions that have further developed and extended the definition.

The four general headings for charitable purposes, which were generally accepted until the enactment of the *Charities Act* 2006, were as set out by decision in the *Pemsel* case, (1891) 3 TC 53. These were as follows.

1. The relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. Other purposes of a charitable nature beneficial to the community not falling under any of the other headings.

Where a charity's purposes were within one of the first three headings, they were assumed to be charitable and for the benefit of the community, unless it was shown otherwise. However for the fourth category a purpose had to be shown to benefit the community in a way the law regarded as charitable.

A purpose contrary to public policy could not be for the benefit of the community; not only would it not be charitable, but it would be void. Charitable status would not be accorded if the purposes:

- contained an over element of self-help; or
- were not exclusively charitable; or
- were substantially political; or
- involved profit distribution.

A wide range of purposes have been accepted in the past as charitable, usually this meant that similar purposes of new organisations would also be accepted as charitable. These included for example:

- the relief of sick, mentally or physically handicapped, disabled or old people, the rehabilitation of offenders or drug abusers and similar purposes;
- the provision of land and buildings for public use, such as recreation grounds and community halls;
- the conservation of the national heritage;
- the care of animals needing protection;
- providing sports facilities open to the public; and
- the provision of recreation facilities, so long as they are in the interests of social welfare and aim to improve the conditions of life for the people for whom the facilities are intended.

All these purposes are limited and defined by decisions of the courts. In the *Charities Act* 2006 most of these purposes became enshrined in law. The four general *Pemsel* case readings have been extended to 13 heads, many with sub-headings, so nearly thirty purposes will be allowed in total!

The main heads are:

- the prevention or relief of poverty;
- the advancement of education;
- the advancement of religion;
- the advancement of health or the saving of lives;
- the advancement of citizenship or community development;
- the advancement of the arts, culture, heritage or science;
- the advancement of amateur sport;
- the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- the advancement of environmental protection or improvement;
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- the advancement of animal welfare;
- the promotion of the efficiency of the armed forces of the Crown; or the efficiency of the police, fire and rescue services or ambulance services; and
- any other purposes charitable in law.

This list covers the majority of purposes which are already charitable. The last category means that everything which is currently charitable is included.

However, in addition another change is that for any organisation to be registered as a charity 'it must be for the public benefit'. All organisations will have to prove public benefit in order to qualify for charitable status. Public benefit is to be judged by the existing body of case law on the subject and Charity Commission guidance.

The Charity Commission will continue to give a ruling on whether proposed purposes are charitable before an organisation is actually formed and a formal application for charitable status is made. The Charity Commission is required to publish guidance relating to the public benefit objective in such a manner as it considers appropriate.

In summer 2011 the results of research carried out by the Charity Commission showed that charities need to do more in order to better meet the requirements of public benefit reporting. For example this research, based on over 1,400 trustees' annual reports, showed that only 26 per cent of charities with income over £500,000 adequately met the full reporting requirements - although 67 per cent of charities did at least meet the basic legal requirements.

Following the decision of the Upper Tribunal in October 2011 in *Independent Schools Council v Charity Commission* [2011] UKUT 421 (TCC) (ISC), the guidance on public benefit and fee-charging charities was withdrawn although the majority of the Charity Commission's public benefit guidance still remained.

The ISC, which represented over 1,200 schools, argued that the previous guidance was being interpreted too narrowly. This was in regard to how schools needed to demonstrate that they offered sufficient benefits to the wider public in addition to those benefits offered to their own fee-paying pupils. In essence the ISC did not want schools to be forced to offer bursaries to poorer students as a condition for keeping their charitable status. They argued that allowing schools greater discretion on how they actually benefitted the wider community was more appropriate. Other mechanisms suggested included sharing facilities and developing partnerships with local state schools.

In June 2012 the Charity Commission published its revised guidance on public benefit for consultation, with a view to issuing the final guidance by end of 2012. The proposed new guidance now states that it is only necessary for a charity to have its charitable purposes regarded as charitable rather than to be judged on the activities it undertakes as stated by the previous guidance. A charitable purpose is one that falls within the descriptions of purposes in the Charities Act and, more importantly, is for the public benefit.

There is a specific section in the new guidance directed at fee-charging charities and the restrictions on excluding the poor. The guidance re-enforces the position that a charity's purposes cannot exclude the poor. It defines the poor not necessarily as those as the poorest in society but those who are on modest means and who can only afford 'low' fees. High fees are therefore fees that are beyond the reach of those people who are on modest means.

Trustees are expected to run the charity to carry out its objects and purposes for the public benefit. However, in doing so trustees are not allowed to exclude the poor. The poor must be able to benefit in more than a purely tokenistic way. Provision also needs to be made for those who are not poor but who cannot afford the full fees. It is clear that the level of provision given by the charity to the beneficiary group remains the decision of the trustees. There are no prescribed financial limits to be followed which will result in any test being passed or failed.

As far as Scotland and Northern Ireland are concerned, it is worth noting at this stage that the Charity Commission has no jurisdiction. The legislation in Scotland relevant to charities is *the Charities and Trustees Investment (Scotland) Act 2005* and the *Charities Accounts (Scotland) Regulations 2010* whilst in Northern Ireland charities are governed by the *Charities Act (Northern Ireland) 2008*. In Scotland HMRC has been replaced as charity authority by the Office of the Scottish Charity Regulator (OSCR).

A charity receives its status by virtue of its objectives and not its legal form. Therefore a charity can be set up, for example as a trust, an unincorporated association, a limited company, a friendly society, a housing association or by an Act of Parliament. A trust is normally used where one or more individuals want to settle property that will be used permanently for charitable purposes, this property is effectively what is known as 'permanent endowment'. In simple terms, an unincorporated association is a club whose members aim to achieve a common charitable purpose. A limited company normally will be incorporated as a company limited by guarantee without share capital.

A charity must have a governing document and the nature of this depends on the legal form of the charity. People who wish to set up a charity are advised to engage a solicitor to prepare the governing document, although some model governing documents exist (the Charity Commission/Charity Law Association).

The individuals in charge of running a charity are called trustees in the legislation governing charities, although they may go under other names in the charity's governing document. For example, a charity which is established as a company limited by guarantee has directors who are therefore also the trustees.

One of the duties that trustees of a charity have is to ensure that the charity's income is used only for the charitable purposes of the charity and that the charity complies with all the legal requirements imposed on charities. The Charities Acts 1992 and 1993, now incorporated into *Charities Act 2011*, made many changes to the law relating to charities, which came into effect in several stages. Their provisions covered charity accounts, charity documents, annual returns to the Charity Commissioners, public collections, the sale of land owned by charities and many other areas.

Most charities' accounts are reasonably well kept and need no major improvements, although undoubtedly, like anything in life, nothing is perfect. However, many charities did not and still fail to keep adequate records. Does this statement of fact really matter? Answer: yes it does. Professional and financial management is essential in the operation of any successful business whether or not the ultimate goal is to make a profit. This is even truer for charities.

Whilst it is probably correct to say that most charities maintain reasonably well-produced accounts which need no major improvement, this unfortunately is not true for all charities. In spite of all the changes in accounting regulations and recommended practices, too many charities are still not keeping adequate records. Whilst successful commercial businesses will inevitably have good professional and financial management, many in the charity world continue to ignore this. It is of