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| Charity accounts and reports: Types of external scrutiny |
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**Contents**

[OG15 B4 Charity accounts and reports: Types of external scrutiny 2](#_Toc144464886)

[Policy Statement/Overview 2](#_Toc144464887)

[Summary of the guidance 2](#_Toc144464888)

[Casework Guidance 2](#_Toc144464889)

[Types of external scrutiny - 31 August 2012 2](#_Toc144464890)

[1. What is an external scrutiny all about? 2](#_Toc144464891)

[2. Independent examination 3](#_Toc144464892)

[3. Who can act as an independent examiner? 3](#_Toc144464893)

[4. Procedural basis of the reporting duties of the independent examiner 5](#_Toc144464894)

[5. Examiners’ reports 5](#_Toc144464895)

[6. Audit under the Charities Act 6](#_Toc144464896)

[7. Audit under the Companies Act 2006 7](#_Toc144464897)

[8. Special arrangements for the audit of NHS charities 7](#_Toc144464898)

[8.1 Introduction 8](#_Toc144464899)

[8.2 Audit and examination 8](#_Toc144464900)

[8.3 Arrangements for Foundation Trusts are different 10](#_Toc144464901)

[9. Who can act as a charity auditor under the Charities Act? 10](#_Toc144464902)

[10. What we can expect of the auditor and the basis of the auditor’s opinion on the accounts 11](#_Toc144464903)

[11. Format of statutory audit report 13](#_Toc144464904)

[12. Forms of audit opinion 14](#_Toc144464905)

[13. Form of Scrutiny prescribed by the charity’s governing document 15](#_Toc144464906)

[14. External scrutiny falls short of minimum statutory requirement 16](#_Toc144464907)

[15. Audit exceptionally ordered by the Charity Commission 16](#_Toc144464908)

[16. Statutory duty to report matters of material significance to the Charity Commission 18](#_Toc144464909)

[17. Application to cap auditors' liability for breach of the statutory duties in Part 8 of the Charities Act or the Companies Act 2006 19](#_Toc144464910)

# OG15 B4 Charity accounts and reports: Types of external scrutiny

# Policy Statement/Overview

# Summary of the guidance

This OG reviews the two types of external scrutiny, independent examination and audit, effective for financial years beginning on or after 1 April 2008 and the new financial thresholds that apply on or after 1 April 2009. It sets out:

* what we can expect,
* the duties of the auditor and examiner, and
* the form and content of their reports, and the special arrangements for NHS charities.

Advice is given on the interpretation of the auditor’s report on the accounts, including when to seek accountancy advice. The OG concludes with our regulatory approach to requests to contractually limit audit liability.

# Casework Guidance

## Types of external scrutiny - 31 August 2012

## 1. What is an external scrutiny all about?

The purpose of an external scrutiny is to provide some form of independent check that what has been stated in the accounts is supported by the evidence obtained through audit or examination procedures and that the accounts show, in the case of an audit, what money came in, what money was spent, and what assets and liabilities the charity has at the end of a financial year in a true and fair way.

A scrutiny either gives the reader assurance about the financial information presented in accounts or it alerts the reader to problems with the accounts.

Charity law and company law set out the duties of those undertaking such work and what must be reported on. The nature of this work varies according to the size of the charity (for further details refer to [CC15b](https://www.gov.uk/government/publications/charity-reporting-and-accounting-the-essentials-cc15b).

There are two forms of scrutiny for charities: independent examination and audit.

What is required of the independent examiner and the auditor is very different and so check first what scrutiny should the charity have had. Both auditors and examiners also have a statutory obligation to report matters of material significance relevant to our statutory inquiry powers and make such a report separately from their scrutiny report on the accounts.

It is possible to have an independent examination of receipts and payments or accruals accounts. Similarly it is possible to have an audit of receipts and payments accounts if the trustees wish to have an audit or the governing document requires an audit. Normally though audits are of accruals accounts.

## 2. Independent examination

Both non-company (unincorporated charities and charitable incorporated organisations) and charitable companies which are below the audit threshold can have an independent examination of their accounts. It should be noted however that the independent examination regime only applies to company charities for accounting periods commencing on or after 1 April 2008.

The role of the examiner and what they have to do is set out in our directions and guidance on independent examination. The examiner has only three things that they must check for and comment on:

* whether accounting records have been kept as required and the accounts accord with those records;
* whether the format of the accounts is in accordance with the Regulations and where appropriate is consistent with the SORP; and
* whether they have come across a matter in the course of their examination which they believe it is appropriate to report.

An independent examination is a less detailed form of scrutiny than an audit both in terms of the depth of work which is to be carried out and the scope of what the examiner has to report upon. It must be remembered that just because there subsequently proves to be a problem with the accounts does not necessarily mean that the examiner did not do a proper independent examination. Unlike auditors, examiners do not plan their work to detect material misstatement due to fraud or error and do not report on whether the accounts give a “true and fair” view.

## 3. Who can act as an independent examiner?

For a charity whose gross income in the financial year is £250,000 or less an independent examiner is described in s.145(1) as “…an independent person who is reasonably believed by the charity trustees to have the requisite ability and practical experience to carry out a competent examination of the accounts…" Our guidance on independent examination sets out in more detail what is meant by ‘independent’ and ‘requisite ability’.

Different rules apply as to who can act as an independent examiner for charities with larger incomes and assets. The following rules apply for financial years starting on or after 27 February 2007:

* Charities with financial year endings on or before 31 March 2009 where gross income in the year exceeds £250,000 and when the charity is not subject to statutory audit (ie gross income is £500,000 or less and gross assets are £2.8m or less, or where gross assets exceed £2.8m the gross income is £100,000 or less); and
* Charities where the financial year end is on or after 1 April 2009 where gross income in the year exceeds £250,000 and when the charity is not subject to statutory audit (ie gross income is £500,000 or less and the gross assets are £3.26 m or less, or where gross assets exceed £3.26m the gross income is £250,000 or less)

In such cases, where gross income exceeds £250,000 and an audit is not required, s.145(3)-(4) of the Charities Act requires that the independent examiner be a member of the following bodies:

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

Under s.145(5) of the Charities Act the Commission may:

* give guidance to trustees in connection with the selection of a person for appointment as an independent examiner;
* give such directions as it thinks appropriate with respect to the carrying out of an examination.

## 4. Procedural basis of the reporting duties of the independent examiner

The Charity Commission’s Directions provide the procedural basis or framework to define how the reporting duties of the examiner must be met.

There are 10 specific Directions that the examiner must address in carrying out an examination. In addition, the examiner should consider if matters have come to their attention which give rise to a separate legal duty to report to the Commission matters of material significance to our regulatory functions. Full details of the Directions and when they apply are set out in our guidance on independent examination.

If there is a concern about whether the examination was properly carried out you should not make a judgement without reference to: the Directions, the examiner’s report and the particulars of the complaint. Before drawing any final conclusions **always** take the advice from a Commission accountant working in your directorate.

## 5. Examiners’ reports

An examiner who has carried out the examination must then make a report to the charity trustees. The legal requirements governing the contents of the report is set out in the Charities (Accounts and Reports) Regulations 2008:

* for non-company and  company charities see Regulation 31;
* for NHS charities see Regulation 32.

In particular, the examiner must state whether or not any matter came to attention that gave reasonable cause to believe that:

* accounting records have not been kept as required by law;
* the accounts do not accord with those accounting records; and
* the format of the accounts is not in accordance with the Regulations and where appropriate is not in consistent with the SORP.

In addition, the examiner must state whether or not any matter has arisen in connection with the examination to which attention should be drawn to enable a proper understanding of the accounts.

The examiner’s report must also state any of the following matters that are identified during the examination:

* any material expenditure or action that appear in breach of trust;
* failure by trustees to provide information and explanations to which the examiner is entitled;

and for accruals accounts only:

* any material inconsistency between the accounts and the trustees annual report ( and in the case of a company charity with its directors’ Report)

Examples of examiners’ reports for different types of charities and examples of “qualifications” which may arise in such reports are set out in our guidance on independent examination – see [CC32](http://www.charitycommission.gov.uk/Publications/cc32.aspx).

## 6. Audit under the Charities Act

A statutory audit under either the Charities Act or the Companies Act 2006 involves a scrutiny of the charity’s annual accounts and underlying financial records.  The reporting duties are set in statute but the report and procedures undertaken by registered auditors are also dictated by auditing standards issued by the Accounting Standards Board which implement international auditing standards.  The auditor applies these standards to the audit procedures undertaken to form an opinion on the accounts and to whether they comply with the legal requirements for accounts. The auditor’s opinion is provided in the form of an audit report, generally addressed to the trustees (or members where the audit is undertaken under the Companies Act) in accordance with statutory obligations or in the case of a non-statutory audit to those who commissioned the audit.

The threshold for audit under charity law is much lower than that set by company law and for accounting periods starting on or after 1 April 2008, company charities not subject to a Companies Act audit are subject to audit where the audit thresholds set for charities under the Charities Act is exceeded. Previously company law included special lower thresholds for charities but these ceased for accounting periods starting on or after 1 April 2008.

An audit under the Charities Act differs from a company audit in that the wording of the audit report reflects requirements of charity law.  The audit procedures that underpin the audit opinion are set in the context of the same auditing standards that apply equally to company and non-company charities.

The requirements for a charity audit report are set out in the Charities (Reports and Accounts) Regulations 2008 as follows:

* non-company charities - Regulation 24;
* company charities - Regulation 25;
* receipts and payments accounts - Regulation 26;
* English NHS charities - Regulation 27;
* Welsh NHS charities - Regulation 28; and
* Charity group accounts - Regulation 30.

**IMPORTANT NOTE:** The duties of the charity auditor are set by regulations made under s.154(1)(b) of the Charities Act (see above). In practice the underlying procedures to meet the requirements of these separate regulations for different categories of charities is broadly similar as is the level of assurance provided except that no opinion is given on whether “receipts and payments” accounts provide a “true and fair” view. An audit report under company law is governed by section 495 of the Companies Act 2006.

In the event of trustees opting for a voluntary audit or the governing document requires an audit but the charity is not required to have a statutory audit, the audit opinion given should be identical to that provided for a statutory audit.

Full detailed guidance for auditors in relation to charity audits is given in Practice Note 11 published by the Auditing Practices Board and obtainable from their [website](http://www.frc.org.uk/getattachment/72589060-0162-4b8d-9c26-5b3367463489/Practice-Note-11-The-Audit-of-Charities-in-the-United-Kingdom.aspx).

## 7. Audit under the Companies Act 2006

Company law for accounting periods starting on or after 1 April 2008 no longer contains special provisions for the audit of charities, however, if a company charity is large enough to exceed the company audit threshold then its audit must be under company law not charity law.

The reporting requirements for an auditor under the Companies Act are set out in section 495 of the Companies Act 2006 and the wording of their audit report follows that of company law and auditing standards. None the less, the same auditing standards and guidance applies as under the Charities Act , including Practice Note 11.

## 8. Special arrangements for the audit of NHS charities

### 8.1 Introduction

There are special arrangements for charities established under the NHS Acts but this section is likely only to be relevant to staff working Operations Liverpool.

NHS charities are registered as independent charities but are established under an NHS Act with statutory charitable objects and constitutional arrangements that regulate all funds held upon trust as well as fundraising activities and audit. These provisions have been consolidated in the NHS Act 2006 and NHS (Wales) Act 2006.

Trusteeship of an NHS charity may take one of the following forms:

* Corporate trustee where the NHS body, an NHS Trust or NHS Foundation Trust or Primary Care Trust, Care Trust or Partnership Mental Health Trust, acts as corporate trustee of funds held on trust; or
* Trustees of an NHS charity appointed under section 11 (s11 of the NHS and Community Care Act 1990) restated under the National Health Service Act 2006 (and in the NHS (Wales) Act 2006); or
* Trustees of an NHS charity appointed under section 22 (s.22 of the Health and Social Care (Community Health and Standards) Act 2003) restated as section 51 of the National Health Service Act 2006; or
* Special trustees appointed under section 29 (s.29 of the National Health Service Reorganisation Act 1973) or under section 95 (s.95 of the National Health Service Act 1977). The relevant 1973 and 1977 Act provisions were consolidated in section 212 of the National Health Service Act 2006 (and in the NHS (Wales) Act 2006).

The Secretary of State for Health (or Welsh Ministers in Wales) determines the trusteeship arrangements for the trust funds linked to each NHS body. The form of the trusteeship applicable to the trust funds of any NHS body can be confirmed by reference to the Department of Health or the Welsh Assembly Government.

### 8.2 Audit and examination

The Regulatory Reform (NHS Charitable and Non-Charitable Trust Accounts and Audit) Order 2005 established the current basis for the audit and examination of NHS charity accounts. The audit threshold remains that set by the Charities Act. The previous arrangements for audit were set out in section 98(1) of the NHS Act 1977, which required, with one exception, that the accounts be audited (no independent examination option) by the Audit Commission’s appointed auditor.

The audit requirements are summarised in the table.

|  |  |  |
| --- | --- | --- |
| NHS Charity | Current arrangements (2005 Order) | Previous arrangements (1977 Act) |
| Corporate trustee: NHS Trust | Audit Commission or Auditor General Wales (WAO) | Audit Commission |
| Section 11 trustee | Audit Commission or Auditor General Wales (WAO) | Audit Commission |
| Corporate trustee: NHS Foundation Trust | Corporate trustee appoints the auditor |  |
| Section 51 (previously s.22) trustee | Trustees appoint the auditor |  |
| Special trustees appointed 1973 | Audit Commission or Auditor General Wales (WAO) | Audit Commission |
| Special trustees appointed 1977 | Audit Commission or Auditor General Wales (WAO) | Audit Commission |

Prior to the 2005 Order and 2003 NHS Act, the accounts for NHS charities were consolidated into the accounts of the Department of Health and audited in accordance with section 98(1) of the NHS Act 1977. There was therefore no scope for independent examination and where the audit of an NHS charity was undertaken by an Audit Commission appointed auditor, who was not a registered auditor in their own right, a dispensation for audit was needed which the Commission granted under the applicable Charities (Accounts and Reports) Regulations.

For NHS charity accounting years beginning on or after 1 April 2004, the Regulatory Reform (NHS Charitable and Non-Charitable Trust Accounts and Audit) Order 2005 defines English and Welsh NHS charities for audit purposes. It continues to exclude Foundation Trusts, acting as corporate and “trustees for” Foundation Trusts (“s51 trustees”), which both remain free to make their own audit arrangements.

Ss.149-150 of the Charities Act remove the need for a dispensation for an audit on an NHS charity where the auditor is appointed by the Audit Commission or the Auditor General for Wales.  A dispensation is still required if an Audit Commission or Auditor General for Wales appointed auditor is to conduct the audit of a charity for a Foundation Trust (corporate or s.22 trustee).

It is at the discretion of the Audit Commission or the Auditor General for Wales to require an audit in place of an independent examination or to opt for an independent examination for an NHS charity covered by ss.149-150. Where an NHS charity wishes to obtain the Charity Commission’s agreement for an independent examination to take the place of an audit, the trustees must seek the prior consent of their Audit Commission or Auditor General Wales appointed auditor before applying for the Charity Commission’s agreement. In any application to us to authorise an independent examination in place of an audit, the trustees must attach the consent letter from their auditor.

The audit thresholds set by the Charities Act are effective for all charities but the trustees of NHS charities cannot opt for an independent examination without the agreement of their auditor. Unlike non NHS charities, a form of scrutiny is always required.

### 8.3 Arrangements for Foundation Trusts are different

NHS Foundation Trusts are constituted as public benefit corporations authorised to provide goods and services for the purposes of the health service in England. The audit arrangements for NHS Foundation Trust section 22 (now s.51) or corporate trustees are found in Schedule 7 to the NHS Act 2006. The constitution provides for separate audit arrangements to be made at the discretion of the Board. The trusts of a Foundation Trust as a corporate trustee or section 51 trustee body are therefore subject to the Charities Act Part 8 and so the auditor must be a registered auditor. Where the Foundation Trust corporate trustee or s51 trustees wish to appoint the Audit Commission or Audit Wales, an audit dispensation must be obtained.

## 9. Who can act as a charity auditor under the Charities Act?

The role of the auditor is a professional one and the auditor has duties in law as to what they must do and report upon, similarly the law restricts the people who can act as an auditor.

**IMPORTANT NOTE:** The legislation covering who is eligible to be appointed as a statutory auditor is contained in s.144(2) of the Charities Act and is limited to those eligible to act as an auditor under company law. The supervisory bodies whose members may be eligible are:

* 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; and
* The Association of Authorised Public Accountants.

S.154(1) of the Charities Act allows additional bodies to be added whose members under the rules of that body would be eligible for appointment as auditor of a charity but to date no additional bodies have been added by regulations.

Auditors for both charitable companies and non-company charities are regulated by a recognised supervisory body (Companies Act 2006 section 1217) and authorised by that body to act as an auditor. Not all members of supervisory bodies are so authorised.

The auditor must be independent of the charity/ company being audited within the meaning of s.1214 of the Companies Act 2006.  (In particular, he or she must not be an officer or employee of the company, or any subsidiary of the company, and must not be the partner or employee of any such person.)

**IMPORTANT NOTE:** If you are in any doubt as to the independence of an auditor, you should obtain accountancy advice.

The purpose of the regulatory framework is to ensure that:

* only those who are properly supervised and appropriately qualified can act as charity auditors; and
* statutory audits are carried out properly, with integrity and with the required independence.

The Auditing Practices Board sets standards (“auditing standards”) for the conduct of audits which are adopted by each recognised supervisory body.

**IMPORTANT NOTE:** Charities (Accounts and Reports) Regulations 2008, regulation 34 does give the Commission a limited power to allow other persons by dispensation to act as auditors.  See OG 15 B3.

## 10. What we can expect of the auditor and the basis of the auditor’s opinion on the accounts

We can have high expectations of the auditor to provide a high quality of independent assurance that the accounts are presented on a true and fair basis and are free from material misstatement or material fraud. This is because they should by following auditing standards:

* identify the risks of material misstatement due to fraud;
* evaluated and tested  internal financial controls;
* understand the charity and its environment;
* carried out analytical procedures;
* carried out substantive checking where necessary to reduce the risk of material misstatement to an acceptably low level;
* obtained sufficient audit evidence to ensure the disclosure of material related party transactions;
* considered subsequent events after the year end for the impact on the accounts;
* tested the reasonableness of the presentation of the accounts on a going concern basis;
* be fully familiar with UK accounting standards including the SORP;
* be fully familiar with audit standards including Practice Note 11;
* be  fully familiar with the regulatory requirements (as set out in CC15b)

At the conclusion of their audit they confirm whether:

* the accounts give a “true and fair view”;

The auditor must report if:

* accounting records have not been kept in accordance with the law;
* the accounts do not accord with the accounting records;
* there is a material inconsistency between the accounts and the annual report, and
* necessary explanations or information have not been made available to them.

An audit is not a statutory inquiry so we cannot necessarily expect the auditor’s work to have covered a specific area of subsequent complaint. A complaint is specific about certain matters but an audit is a general systematic evaluation as to whether the accounts are “true and fair” and free from material misstatement due to error or fraud not totally free of error or fraud.

**IMPORTANT NOTE:** Also whilst an auditor is independent of the charity and trustees, they are appointed by the charity and may at times also be engaged in an advisory capacity or even as an agent of a charity defending a particular approach or disclosure. This can create risk recognised in ethical standards.  Where we are in communication with an auditor acting as agent for a charity in relation to an accounting or financial matter it is **essential** to obtain accountancy advice beforehand and when in communication with the auditor.

Audit opinions are written in quite technical language reflecting the requirements of the law and the professional requirements placed on auditors by international auditing standards.

International auditing standards require the auditor’s report to include a paragraph briefly explaining the audit process – eg, that the examination is on a test basis and involves assessing significant estimates and judgements, and that the auditor has complied with auditing standards.  A statement is also included to explain that audits are planned and performed to provide reasonable assurance that the accounts are free from material misstatement.

The audit opinion will include an opinion as to whether the accounts give a “true and fair” view.

Where the auditor cannot give an “unqualified opinion” that states that the accounts do indeed give a “true and fair” view they will offer a modified opinion in their statutory audit report.

## 11. Format of statutory audit report

Auditors’ reports on accounts should contain a clear expression of opinion, based on review and assessment of the conclusions drawn from evidence obtained in the course of the audit.  The audit report must provide the opinions and statements required by legislation, but the auditor also needs to address the requirements of International Standards of Auditing and guidance produced by the Auditing Practices Board.

**IMPORTANT NOTE:** Audit reports are written in quite technical language and it is always recommended that in the event of doubt or a concern you seek the advice of a Commission accountant.

For audit reports, International Auditing Standard (UK and Ireland) No. 700 sets out the basic elements of a report as:

* a title identifying to whom the report is addressed;
* identification of the accounts audited;
* separate headed sections dealing with:
  + the respective duties of directors/trustees and auditors in relation to the preparation of the accounts (this is not included where the accounts or annual report contain a similar statement of responsibilities);
  + reference to audit standards;
  + a description of the work the auditor performed;
  + reference to accounting standards used in the preparation of the accounts;
  + the auditors’ opinion;
* the signature of the auditor, their address; and
* the date of the audit report.

**IMPORTANT NOTE:** For accounting periods starting on or after 1 April 2008, the form of the audit report for charities is also specified in the Charities (Accounts and Reports) Regulations 2008.

## 12. Forms of audit opinion

**A standard or unqualified expression of opinion**

The Auditing Practices Board, Practice Note 11 provides standard wording for unqualified expressions of opinion, depending on the constitution of the charity:

* charitable companies: “in our opinion the financial statements give a true and fair view of the charitable company’s state of affairs as at [date] and of its incoming resources and application of resources, including its income and expenditure, in the year then ended and have been properly prepared in accordance with the Companies Act 2006”;
* unincorporated (non-company) charities preparing accruals accounts: “in our opinion the financial statements give a true and fair view of the charity’s state of affairs as at [date] and of its incoming resources and application of resources in the year then ended and have been properly prepared in accordance with the Charities Act”;

**A modified report**

You should look very closely at any report where the auditor’s opinion does not in substance follow one of the above forms of wording – even if it is not formally qualified and always take the advice of a Commission accountant.  An auditors report  is considered to be modified in the following situations;

Matters that **do not** affect the Auditor’s opinion:

i) Emphasis of matter

In this case the auditor will have added a paragraph to the report to highlight a matter affecting the financial statements which is included in the notes to the financial statements that more extensively discusses the matter. This will usually be added after the opinion paragraph and would ordinarily refer to the fact that the auditor’s opinion is not qualified in this respect.

Matters that **do** affect the auditors opinion:

ii) Qualified opinion

In this case the auditor has concluded that an unqualified opinion cannot be expressed but that the effect of any disagreement with management or limitation of scope is not so material or pervasive as to require an adverse or disclaimer of opinion. A qualified opinion will be expressed as being “except for” the effects of the matter to which the qualification relates.

iii) Disclaimer of opinion

In this case the possible effect of a limitation of scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

iv) Adverse opinion

In this case the effect of a disagreement is so material and pervasive to the financial statements that the auditor has concluded that a qualification is not adequate to disclose the misleading or incomplete nature of the financial statements.

Whenever an auditor expresses an opinion which is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s) on the financial statements.

**IMPORTANT NOTE:** Whenever you encounter a modified (qualified) audit report and the accounts are being used as part of your casework, whether for compliance, specialist casework, monitoring or other work you should always obtain accountancy advice from the Commission accountant for your business area.

## 13. Form of Scrutiny prescribed by the charity’s governing document

Some charities are obliged by their governing document to have a more rigorous external scrutiny of their accounts than would otherwise be required by statute.  For instance:

The type of external scrutiny required (audit or independent examination) will depend upon the precise wording, and the context of the wording of the governing document.  Very often, the word "audit" will be used.  "Audit" is a word which is capable of being used to describe different types of external scrutiny of accounts, from an audit by a registered auditor, to an independent check by a non-accountant.

In some cases, a decision is easy, so that:

* an expression such as "audit by a qualified auditor" is likely to mean that the accounts should be audited by a registered auditor - as in the statutory regime - whether or not the charity is over the statutory financial threshold for the audit requirement.
* an expression such as "audit by someone with financial experience, such as a bank manager", is likely to mean an independent examination.  But, of course, if the charity is over the statutory financial threshold for the audit requirement, the accounts will be subject to a statutory audit, and the provision in the governing document for scrutiny is disregarded.

It is not always easy to say whether a provision in a governing document does or does not impose a more rigorous accounts' scrutiny requirement than does the Charities Act. It all depends on deciding what the person who founded the charity actually meant. Company charities have the flexibility to amend their Articles under company law to change such a requirement. Similarly under s.280 of the Charities Act non-company charities may amend their governing document to remove this requirement.

**IMPORTANT NOTE:** Where there is doubt, legal or accountancy advice should be taken.

If the governing document of a charity requires a level of external scrutiny of accounts which exceeds the current statutory requirements, the trustees may wish to use their powers of amendment to change the requirements in the charity’s governing documents.

Some kind of audit or an independent examination or other external scrutiny of the accounts may also be required or imposed on the charity for other reasons, or for special purposes.  Examples are:

* the wishes of a donor;
* the terms imposed by a funding body; or
* the terms of an agreement with a financial (eg loan-making) institution.

Sometimes, the imposition of an audit in these circumstances can be onerous and costly.

## 14. External scrutiny falls short of minimum statutory requirement

**IMPORTANT NOTE:** If the form of accounts scrutiny conducted and/or the resulting report on the accounts fall short of the minimum statutory requirement for that charity, **always seek** accountancy advice.

## 15. Audit exceptionally ordered by the Charity Commission

We can make an Order to have the accounts of a charity audited if:

(a) the charity is not a charitable company which is required to be audited under the Companies Act 2006; and

(i) the accounts are liable under Part 8 of the Charities Act to be audited or independently examined (see section 2 above) and have not been audited or independently examined by a person authorised to do so; or

(ii) the accounts are not liable under Part 8 to be audited (see [section 3](http://ogs.charitycommission.gov.uk/g015a005.aspx#tab3#heading_toc_rh_10)), and the charity has not elected to have the accounts audited, but we consider an audit desirable;

or:

(b )the charity is a charitable company auditable under the Companies Act 2006 (regardless of whether its accounts for the financial year have been audited).

It may on occasions be appropriate to call for an audit in regulatory-type cases where we are uncertain about the charity’s financial position.

OG 117 A2 How the Commission deals with investigations work: Considering cases in the Regulatory Framework looks at our regulatory approach. This will include issues such as:-

* the breakdown of a charity’s administration;
* the misapplication of charity assets; and
* breach of trust.

Where a statutory inquiry is open we can require the submission of compliant accounts if they relate to any matter in question – see section 8.  This can be combined with the use of this power where we are looking at the risk of harm to the charity due to the failure to comply.

In the case of (a), we make the Order under s.146(1) or s.153(1) of the Act. We appoint and pay the auditor and can recover the costs from the charity trustees (or failing that) from the funds of the charity, except where the charity trustees have complied, having appointed an independent examiner, and they appoint an auditor as we require them to by our order. In either case, the auditor we appoint must be a "charity auditor".

In the case of (b) we make our Order under s.147 of the Act. We appoint the auditor (who must be a "company auditor"), but we must bear the cost.

**IMPORTANT NOTE:** Where consideration is being given to our appointment of an audit, the advice of a Commission accountant should always be taken to see if the relevant information can be obtained elsewhere. If not, the power may be exercisable. Before exercising the power, however, legal advice should be taken on whether this is appropriate or proportionate.

## 16. Statutory duty to report matters of material significance to the Charity Commission

Ss.156, 158 and 159 of the Charities Act place a duty upon the independent examiners or auditors of  both the non-company and company charities to make a report to the Charity Commission, where in the course of their examination, they identify a matter, which relates to the activities or affairs of the charity or of any connected institution or body, and which the examiner or auditor has reasonable cause to believe is likely to be of material significance for the purposes of the exercise by the Commission of its functions under s.46, s.76 and s.84 of the Charities Act.

This duty applied from 1 April 2008 and replaced any existing duty.  Guidance on when and how to report is given for auditors in APB guidance PN11 and for examiners in our guidance on independent examination.

This duty also applies to reporting accountants for company charities from 1 April 2008 but the reporting accountant regime is no longer in place for accounting periods beginning on or after 1 April 2008 because it has been replaced by independent examination.  However, any reporting accountants reporting for prior periods must comply with the duty from 1 April.

There are 8 matters identified as being of material significance:

* matters suggesting dishonesty or fraud involving a significant loss of, or a major risk to, charitable funds or assets;
* failure(s) of internal controls, including failure(s) in charity governance, that resulted in a significant loss or misappropriation of charitable funds, or which leads to significant charitable funds being put at major risk;
* matters leading to the knowledge or suspicion that the charity or charitable funds have been used for money laundering or such funds are the proceeds of serious organised crime or that the charity is a conduit for criminal activity;
* matters leading to the belief or suspicion that the charity, its trustees, employees or assets, have been involved in or used to support terrorism or proscribed organisations in the UK or outside of the UK;
* evidence suggesting that in the way the charity carries out its work relating to the care and welfare of beneficiaries, the charity’s beneficiaries have been or were put at significant risk of abuse or mistreatment;
* significant or recurring breach(es) of either a legislative requirement or of the charity’s trusts;
* a deliberate or significant breach of an order or direction made by a charity regulator under statutory powers including suspending a charity trustee, prohibiting a particular transaction or activity or granting consent on particular terms involving significant charitable assets or liabilities; and
* the notification on ceasing to hold office or resigning from office, of those matters reported to the charity’s trustees.

## 17. Application to cap auditors' liability for breach of the statutory duties in Part 8 of the Charities Act or the Companies Act 2006

In our view, it is not legally possible for auditors to limit (or "cap") their liability for breach of their statutory duties under Part 8 of the Charities Act when undertaking a statutory audit of a charity's accounts.

The view is not, however, shared by all auditors.  Some consider that the charity trustees of charities which are not companies are able to agree to cap the liability of an auditor for breach of the statutory duties in Part 8.

If we are asked by charity trustees for our view as to whether or not they should agree to a cap, we should say that, in our opinion, an agreement to a cap would have no legal effect.  We should, however, recognise that the legal position is not certain.  If trustees agree to cap their auditor's liability, and a breach of the statutory duty by the auditor gives rise to a loss to the charity, and that loss exceeds the cap, the auditor may be able to escape liability for that part of the loss which exceeds the cap.

The question would then arise whether the trustees themselves were personally liable for the balance, on the basis that, by agreeing to the cap, they were not acting in the interests of the charity.  The answer would depend on an analysis of the benefits obtained by the charity by agreeing to the cap (eg a lower audit fee), against the risks involved in agreeing to the cap.  The risks would obviously depend on the size of the charity's assets relative to the amount of the cap, the nature of its business and governance arrangements and so on.

We should not authorise agreement to a cap by Order under s.105 of the Charities Act, or express an opinion that it is proper for trustees to agree to a cap, without taking legal advice.  The effect would be to improve the auditor's chance of being able to enforce the cap.

With regard to an audit of the accounts of a charitable company,  there is an explicit statutory provision (Part 16 Chapter 6 Companies Act 2006), which prohibits the auditors of charitable companies contracting out of liability for breach of their statutory duties as auditors except as may be permitted by sections 534 and 535.

**IMPORTANT NOTE:** Legal advice will be required to establish whether these sections apply.

Where after the event relief from liability is requested, whether the issue arose in relation to a cap or not, reference should be made to OG 98 outlining the circumstances under which we may use our powers to grant a relief from a liability as a result of a breach of trust or duty under charity law.

For audit dispensations, refer to OG 15 B3.