EXPLANATORY MEMORANDUM TO

THE CHARITIES (ACCOUNTS AND REPORTS) REGULATIONS 2008

2008 No. 629

1. This explanatory memorandum has been prepared by the Cabinet Office and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 The Charities (Accounts and Reports) Regulations 2008 ("the 2008 Regulations") makes a number of changes to the accounting, reporting and scrutiny requirements for charities that are necessary as a consequence of the changes made to Part 6 of the Charities Act 1993 ("the 1993 Act") by:

- the Charities Act 2006 ("the 2006 Act");
- the Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 (S.I. 2008/527) ("the 2008 Order"); and,
- the Regulatory Reform (National Health Service Charitable and Non-Charitable Trust and Accounts) Order 2005 (S.I. 2005/1074) ("the 2005 Order").

2.2 The 2008 Regulations also include provisions relating to the reporting of public benefit within the trustees' annual report, and update the regulations for common investment funds and common deposit funds (investment fund charities).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Part 6 of the 1993 Act provides the accounting and reporting framework for charities. It confers powers on the Minister for the Cabinet Office to make regulations to support the accounting and reporting framework, which primarily provide for:

a) The content of charities' annual reports;
b) The form and content of charities' accounts;
c) The methods and principles adopted in preparing charities' accounts; and,
d) Information to be provided by way of notes to charities' accounts.

4.2 The Charities (Accounts and Reports) Regulations 2005 (S.I. 2005/572) ("the 2005 Regulations") currently make provision for the form and content of charity accounts, the methods and principles adopted in their preparation, notes to the accounts, and for an annual report containing information on the activities of the charity, along with other information about the charity, its trustees and officers. Part 6 of the 1993 Act requires charities to produce accounts and sets out the cases in which those accounts must be scrutinised either by means of an independent examination or an audit. The 2005

Regulations currently set out the detailed requirements for the scrutiny of those accounts. The 2008 Regulations will supersede the 2005 Regulations.

4.3 Section 1175 of and Schedule 9 to the Companies Act 2006[1] will remove the existing company law scrutiny provisions for charitable companies below the company law audit threshold. The 2008 Order will apply the charity law accounts scrutiny provisions to charitable companies that are not required to be audited as a matter of company law. These provisions are due to come into force on 1st April 2008 for the financial years of charities beginning on or after that date.

4.4 Schedule 5A to the 1993 Act, which was inserted by section 30 of the Charities Act 2006, introduces for the first time the requirement for the preparation of group accounts by parent charities and the scrutiny of those accounts. The 2008 Order applies the charity law group accounts preparation and scrutiny requirements to groups headed by charitable companies where they are not required to prepare group accounts under company law. These provisions are due to come into force on 1 April 2008 for the financial years of charities beginning on or after that date.

4.5 The Office of the Third Sector carried out a consultation on draft Regulations, which is available on the website of the Office of the Third Sector[2].

4.6 The 2008 Regulations are made by the Minister for the Cabinet Office, in exercise of the powers conferred upon him by sections 43, 44, 45 and 86(3) of the 1993 Act after consultation as required by section 86(4) of the 1993 Act.

4.7 The Office of the Third Sector has published an informal consolidation of Part 6 of and Schedule 5A to the 1993 Act on its website, to reflect the changes made by the 2006 Act and the 2008 Order at commencement.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The 2006 Act makes a number of changes to Part 6 of the 1993 Act. Perhaps the most significant change is that it inserts a new section 49A and Schedule 5A into the 1993 Act which creates a new provision for the preparation and scrutiny of group accounts of parent charities and their subsidiary undertakings. The 2008 Regulations:

- set thresholds for the preparation of group accounts by parent charities, and for the scrutiny of those accounts;

[1] A copy of the Companies Act 2006 is available on the website of the Office of Public Sector Information: http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en_1.

[2] www.cabinetoffice.gov.uk/third_sector/Consultations/completed_consultations/audit_accounting_reporting.aspx

- provide a framework for the preparation and scrutiny of such group accounts, and, where group accounts are prepared, for the expansion of the annual reports currently prepared by parent charities so as to include information relating to their subsidiary undertaking(s).

7.2 There are other changes made by the 2006 Act to Part 6 of the 1993 Act which are reflected in the 2008 Regulations. These are –

7.2.1 The enactment of a whistle-blowing duty applying to charity auditors and examiners (new section 44A of the 1993 Act which is expected to come into force on 1st April 2008) removes the need for this issue to be addressed through regulations as it is currently. The 2008 Regulations therefore do not include any additional whistle-blowing duty.

7.2.2 The imposition of a stricter qualification requirement for independent examiners, in cases where the income of the charity exceeds £250,000 (new section 43(3A)) of the 1993 Act, also gives rise to minor changes to the current regulations. The 2008 Regulations will require such examiners to report on the qualification that they hold.

7.2.3 The enactment of special rules relating to the disclosure of charitable grants contained in the new section 42(2A) of the 1993 Act (introduced by paragraph 133 of Schedule 8 to the 2006 Act which is expected to come into force on 1st April 2008) is considered to have the effect that paragraph 1(o) of schedule 1 to the 2005 Regulations would go beyond the powers which section 42(2) of the 1993 Act confers if that provision were contained in the 2008 Regulations. The 2008 Regulations, therefore, restrict the requirements to disclose information about individual recipients of grants from charities to ensure compatibility with the 1993 Act.

7.2.4 The 2005 Order introduced a special accounts scrutiny regime for charities administered by health service bodies in England and Wales. This regime was changed in some respects by the 2006 Act. A number of amendments to the 2005 Regulations are also required as a consequence of these changes, and are reflected in the 2008 Regulations.

7.2.5 The 2006 Act reinforced the requirement that all charities must have charitable purposes which are for the public benefit. The 2008 Regulations include provision that sets the reporting of activities and achievements in the Trustees' Annual Report in the context of furthering the charity's purposes for the public benefit, and for trustees to confirm that they have had regard to the Commission's guidance on public benefit where that has been relevant.

7.2.6 The 2008 Regulations update provisions that apply to investment fund charities to bring them into line with the Investment Management Association's Statement of Recommended Accounting Practice for the Financial Statements of Authorised Funds ("the IMA SORP") which was revised in December 2005. There are fewer than 50 of this type of specialised charity.

7.3 The Office of the Third Sector undertook a 13 week public consultation on draft Charities (Accounts and Reports) Regulations, in 2007. The consultation was brought to the attention of subscribers to the Office's Charities Act implementation e-mail update group (over 800), as well as targeted mailings or e-mails to sector technical experts, professional bodies and advisers, umbrella groups, and those who expressed an interest in the Commission's public benefit consultation.

7.4 86 responses were received to the consultation. Most respondents were supportive of the draft Regulations. Several respondents offered comments on the proposals and the drafting. Consultation responses are summarised in the Annex to the Impact Assessment, attached to this memorandum.

7.5 The Regulations will take effect for the financial years of charities beginning on or after 1 April 2008, at the same time as the relevant provisions of the Companies Act 2006 and Charities Act 2006 are brought into force.

7.6 Some respondents commented on the complexity of the legislation, given the changes being made to the 1993 Act by both the 2006 Act and the 2008 Order. The Office of the Third Sector has published an informal consolidated version of Part 6 of, and Schedule 5A to, the Charities Act 1993 to show the effect of these changes at commencement.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum. This includes a full summary of consultation responses.

9. Contact

9.1 Ben Harrison at the Office of the Third Sector, Cabinet Office, Tel: 020 7276 6029 or e-mail: ben.harrison@cabinet-office.x.gsi.gov.uk, can answer any queries regarding the instrument.

Regulatory Impact Assessment

Summary: Intervention & Options

Department /Agency:	Title:	
Office of the Third Sector, Cabinet Office Charity Commission	**Impact Assessment of The Charities (Accounts and Reports) Regulations 2008**	
Stage: Final / Implementation	**Version:** 2.01	**Date:** 27 February 2008

Related Publications:

The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008

Consultation package on changes to the Accounting and Reporting Framework for Charities (June 2007)

Informal consolidation of Part 6 and Schedule 5A of the Charities Act 1993

Available to view or download at:

http://www.cabinet-office.gov.uk/thirdsector

Contacts for enquiries: Ben Harrison, Office of the Third Sector **Telephone:** 020 7276 6029

What is the problem under consideration? Why is government intervention necessary?

This Regulatory Impact Assessment (RIA) examines the impact of additions and changes to the accounting and reporting requirements currently placed on charities in England and Wales by the Charities (Accounts and Report) Regulations 2005 SI 572 ("the 2005 Regulations") that are considered necessary as a consequence of the changes to Part 6 of the Charities Act 1993 ("the 1993 Act") made by the Charities Act 2006 ("the 2006 Act"). The Charities (Accounts and Reports) Regulations 2008 will supersede the 2005 Regulations.

Perhaps the most significant change introduced by the 2006 Act is the insertion of a new section 49A and Schedule 5A into the 1993 which creates a new provision for the preparation and scrutiny of the group accounts of parent charities and their subsidiary undertakings. The Regulations are required to provide a framework enabling the preparation of group accounts, related notes and their audit together with an expanded trustees' annual report that includes the activities of subsidiary undertakings.

Another important change in the new Regulations are new requirements in the Trustees Annual Report which emphasise the reporting of the charity's activities in the context of the charity's charitable purposes for the public benefit, and a requirement for trustees to confirm that they have paid regard to the Charity Commission's guidance on public benefit where appropriate.

A separate Impact Assessment examines the impact of other changes to Part 6 of the 1993 Act which will be made by the Charities Act 2006 (Amendments reflecting changes in Company Law Audit Provisions) Order 2008 ("the draft section 77 order"). In particular, that RIA looks at changes in the accounts scrutiny regime for charities that are companies which will occur when section 1175 and Schedule 9 of the Companies Act 2006 are brought into force. Regulations will be necessary to provide for the reporting duties of auditors and independent examiners of charitable companies where the accounts will not have to be audited under company law.

A separate Impact Assessment has also been prepared for Investment Fund charities.

What are the policy objectives and the intended effects?

The purpose of updating the Regulations is to:

- provide a concise yet workable framework for the preparation and audit of group or consolidated accounts and to provide for the content of the notes to group accounts and the accompanying group annual report;
- set the reporting of the charity's activities and achievements in the context of public benefit, as part of the trustees' annual report, and require the trustees to confirm that they have had regard to the Commission's public benefit guidance where relevant;
- Reflect other changes that have been made by the Charities Act 2006 or other legislation.

The Regulations reflect current sector practice and are consistent with financial reporting standards and practice and the recommendations contained within the Charities Statement of Recommended Practice (SORP).

What policy options have been considered? Please justify any preferred option.

The preparation and audit of group accounts and the content of group annual reports

Option 1: Rely on existing regulations

Without the Regulations, a legal requirement would exist requiring the preparation of group accounts, notes to the accounts and a group annual report. However, there would be no framework within Regulations for their preparation or for their content. Regulatory costs would still arise from this legislative requirement but preparers would lack the framework necessary to implement these requirements without the Regulations. Similar issues would arise in the context of auditors' reporting duties. A duty to report would exist in law but there would be no framework setting consistent reporting duties that apply to all auditors of group accounts. Although use could be made of existing voluntary best practice, such as the Charities SORP, the uncertainty as to the appropriate form and content may cause increased compliance costs and inconsistent practices.

This option would not provide any benefits as it would fail to deliver a framework that can be applied consistently to the preparation of group accounts and their audit. Compliance costs would not be reduced by this option.

Option 2: Implement the Regulations (the preferred option)

This option involves the introduction of Regulations to create a necessary legal framework for group accounts prepared under the 1993 Act and their audit. The approach has been to create a workable framework for the preparation and audit of group accounts and to do so as economically as possible in terms of the requirements introduced.

A concise and workable framework is provided building on the framework that already exists under the 2005 Regulations for individual accounts of charities and the Charities SORP. The preparation of group accounts is already voluntary sector best practice, and so the threshold set does not create any additional compliance cost for the vast majority of parent charities that already prepare group accounts.

Option 3: Implement the Regulations but at a higher income threshold

The preparation and audit of group accounts is now general practice within the charity sector. The threshold set for the preparation of group accounts mirrors that recommended by the Charities SORP and creates audit and preparation thresholds based on the aggregate gross income of a group rather than just that of parent charity.

This approach would increase some risks as parent charities could avoid audit by using subsidiaries and thereby reducing the income received directly by a charity to a level below the audit threshold applying to individual charity accounts. Also the transparency and accountability of a charity which uses subsidiaries, as opposed to its peers which may not, would be reduced and information relating to activities and resources controlled through subsidiaries would not be as accessible to stakeholders and other users of accounts.

Whilst compliance costs would not necessarily be reduced, this option would recognise sector practice in this area, but only make group accounting, audit and annual reporting mandatory at a higher level of income. This option places reliance on the continued application of good accounting practice in this area by the sector and an acceptance that a minority may choose not to prepare group accounts in the absence of regulatory requirements.

What policy options have been considered? Please justify any preferred option.

Reporting public benefit in trustees' annual reports

Option 1 – Do nothing

All charities must have charitable purposes which are for the public benefit. In the absence of a reporting mechanism in relation to public benefit a number of objectives inherent in the 2006 Act are risked. For example there would be a greater risk of:

- there being organisations on the register of charities which do not meet the public benefit requirement;
- the Charity Commission not fulfilling its statutory public benefit objective; and
- damage to public trust and confidence.

The benefit of this approach would be no increase in the regulatory burden on the sector.

Option 2 – Implement the Regulations (the preferred option)

This option recognises the central role of the trustees' annual report in providing information about a charity's aims, objective, activities and achievements and proposes that this established reporting mechanism is used to set that information in the context of the charity's charitable purposes for the public benefit.

All registered charities below the audit threshold (gross income of £500,000 or less and an aggregate value of assets of £2.8m or less where income exceeds £100,000) would set the brief summary of their main activities undertaken to further its purposes for the public benefit. Larger charities, with a statutory audit requirement, would provide a review of significant activities undertaken in order to further its purposes for the public benefit as well as giving information about it aims and objectives and resulting achievements.

All registered charities would include a simple statement in their trustees' annual report confirming that the charity trustees have paid due regard to any guidance published by the Charity Commission under section 4 of the 2006 Act in relation to the public benefit requirement in their administration of their charity.

It should be noted that proposals for simplifying various charity law thresholds, including increasing the threshold for the preparation of the Trustees' Annual Report, were published for consultation in December 2007. If a proposal to increase the threshold for the preparation of the Trustees' Annual Report is taken forward, this would reduce the number of charities affected by these regulations.

This approach supports greater transparency in sector reporting creating a focus on a charity's activities undertaken to support its purposes for the benefit of the public thereby enhancing public trust and confidence in their work. In addition, trustees are made aware, through reference to Charity Commission guidance, of how to fulfil their obligations to ensure their charity provides public benefit.

Option 3 – Reporting public benefit though the Commission's Annual Return process

An alternative approach would be for charities to report on their public benefit through the Charity Commission's Annual Return process. For example, charities with an annual income between £10,000 and £100,000 could self certify on their Annual Return that their charity continues to meet the public benefit requirement and that they have had regard to Charity Commission guidance on public benefit where relevant.

Charities with an annual income between £100,000 and £1 million could provide a written explanation in their trustees' annual report of how they consider their charity meets the public benefit requirement.

Charities with an annual income over £1 million could provide a fuller written explanation of how they consider their charity meets the public benefit requirement in its Summary Information Return.

The Charity Commission considered this option, but rejected it at an early stage because of concerns that:

- the three different reporting formats might be confusing for charity trustees and their advisors;
- it introduced a new, arbitrary reporting threshold of £100,000;
- it would offer no regulatory savings compared with the option 2 of reporting information through the trustees' annual report; and

- using the annual report provides a higher level of public accountability and a more coherent framework.

This option offers no regulatory costs savings or benefits compared with option 2 and is more complex.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The impact of the Regulations will be monitored on an ongoing basis by the Charity Commission and the Office of the Third Sector.

The government has committed to reviewing the impact of the public benefit requirement within three years of its commencement. That review will encompass the reporting of public benefit through the Trustees' Annual Report.

The 2006 Act also requires (section 73) the Minister for the Cabinet Office to appoint a person to evaluate the impact of the Act within five years of Royal Assent (i.e. by November 2011), and report on his or her findings to Parliament.

Ministerial Sign-off For Final / Implementation Stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

6th March 2008

Phil Hope MP

Parliamentary Secretary,

Cabinet Office

Date:

Summary: Analysis & Evidence

Policy Option: 2	Description: **Implement the Charities (Accounts and Reports) Regulations 2008 - in relation to group accounts**

COSTS

ANNUAL COSTS	
One-off (Transition)	**Yrs**
£ 95,612	1
Average Annual Cost (excluding one-off)	
£ 675,692	

Description and scale of **key monetised costs** by 'main affected groups'.

2,043 charity headed groups with an income over £500,000 affected by these changes. Main costs involved relate to: preparation of group accounts and related notes to the accounts; audit of group accounts; group annual reporting; training and familiarisation (first year only).

Total Cost (PV) **£ 771,304**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS	
One-off	**Yrs**
£ -	
Average Annual Benefit (excluding one-off)	
£ -	

Description and scale of **key monetised benefits** by 'main affected groups'.

Total Benefit (PV) **£ -**

Other **key non-monetised benefits** by 'main affected groups'

Key Assumptions/Sensitivities/Risks

Evidence-based assumption that under business as usual rules (BAU) 95% of charity groups already prepare group accounts as a matter of best practice on a non-statutory basis (this is based on evidence from a sample of accounts submitted to the Charity Commission).

What is the geographic coverage of the policy/option?				England and Wales
On what date will the policy be implemented?				1 April 2008
Which organisation(s) will enforce the policy?				Charity Commission
What is the total annual cost of enforcement for these organisations?				N/A
Does enforcement comply with Hampton principles?				Yes
Will implementation go beyond minimum EU requirements?				N/A
What is the value of the proposed offsetting measure per year?				N/A
What is the value of changes in greenhouse gas emissions?				N/A
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off)	£0 - £500k N/A	£500k-£5.6m £331	>£5.6m £331	Excepted & Exempt £331
Are any of these organisations exempt?	Yes	Yes	No	Yes

Impact on Charity Commission Admin Burdens Baseline (2005 Prices) Increase of

Increase of **£ 675,692** Decrease of **£ -** **Net Impact** **£675,692**

Key:	**Annual costs and benefits: Constant Prices**	**(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: 2	Description: Implementing the Charities (Accounts and Reports) Regulations 2008 – reporting public benefit

COSTS

ANNUAL COSTS	
One-off (Transition)	**Yrs**
£ 603,500	1
Average Annual Cost (excluding one-off)	
£ 756,000	

Description and scale of **key monetised costs** by 'main affected groups'

The requirement will have a cost impact for all registered charities with an income over £500,000 (8,620). It will also affect those charities which are currently exempt or excepted but which will be required to register (2,500).

Total Cost (PV) **£ 1,359,500**

Other **key non-monetised costs** by 'main affected groups'

N/A

BENEFITS

ANNUAL BENEFITS	
One-off	**Yrs**
£	
Average Annual Benefit (excluding one-off)	
£	

Description and scale of **key monetised benefits** by 'main affected groups'

Total Benefit (PV) **£ -**

Other **key non-monetised benefits** by 'main affected groups'

Using the existing reporting mechanism of the Trustees' Annual Report is recognised as the most cost-effective and proportionate way for charities to explain their activities and achievements in the context of furthering their purposes for the public benefit.

Key Assumptions/Sensitivities/Risks

No additional costs for Non-auditable charities. Consideration of a charity's purposes is inherent in a trustee's duties and therefore no additional compliance cost should arise. Similarly, the minor refocusing of information already held in the Trustees' Annual Report is not considered to give rise to any additional regulatory costs.

What is the geographic coverage of the policy/option?			England and Wales	
On what date will the policy be implemented?			1 April 2008	
Which organisation(s) will enforce the policy?			Charity Commission	
What is the total annual cost of enforcement for these organisations?			N/A	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			N/A	
What is the value of changes in greenhouse gas emissions?			N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	£0 - £10k N/A	£10k-£500k £0	£500k-£1M £54 - £81	>£1M £54 - £81
Are any of these organisations exempt?	Yes	No	No	No

Impact on Charity Commission Admin Burdens Baseline (2005 Prices) Increase of

Increase of £756,000 Decrease of £ - **Net Impact** **£756,000**

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value

Evidence Base (for summary sheets)

Background

Background - The preparation and audit of group accounts and the content of group annual reports

1. The Regulations:

   - set the threshold requirements for the preparation of group accounts by parent charities, and for the scrutiny of those accounts;

   - provide a framework for the preparation group accounts, including notes to the accounts and for the expansion of the trustees' annual reports so as to include information relating to subsidiary undertaking(s).

2. The purpose of the Regulations is to provide a concise yet workable framework for the preparation of group or consolidated accounts and to provide for the content of the notes to group accounts and the accompanying group annual report. The Regulations reflect current sector practice and are consistent with financial reporting standards and practice and the recommendations contained within the Charities Statement of Recommended Practice (SORP).

3. Similar objectives apply to the reporting duties placed on auditors of group accounts. Again current sector practice for most non-company charities preparing group accounts is to extend the auditors' duties under the 1993 Act, that apply to individual accounts, to include an audit opinion on the group accounts. The Regulations build on these existing reporting duties and provide similar reporting duties in the context of group accounts.

4. In the context of parent charities that are companies preparing group accounts under the 1993 Act, a similar approach is adopted, with existing reporting duties placed on charity auditors modified to reflect company law and to enable an audit opinion to be given on the group accounts.

5. The overall purpose of the changes is to ensure that the accounting and reporting framework continues to be relevant to charities' reporting needs and to maintain appropriate accountability to stakeholders and the wider public for the resources controlled.

6. The 2006 Act inserts a new section 49A and Schedule 5A into the 1993 Act which creates new provisions for the preparation and audit of group accounts of parent charities and their subsidiary undertakings. The draft section 77 order will extend the scope of these provisions to those parent charities which are companies but which do not, under company law, have an obligation to prepare group accounts.

7. Before this change, the preparation of group accounts was a practice recommended by the Charities SORP and applied to those charities where the combined income of the group exceeded the statutory charity audit threshold for individual accounts. The preparation of group accounts is now general sector practice. However, until the 1993 Act was amended by the 2006 Act, no legal status was given to group accounts by charity law.

8. Charity law only required the preparation of entity or individual accounts reflecting those activities carried out directly by the charity and the resources it controlled directly. Similarly, there was no legal provision for an annual report to accompany group accounts.

9. However, charities are making increasing use of group structures using trading subsidiaries to undertake income generating trades and, on occasions, to conduct certain of their charitable activities through subsidiaries to help isolate the charity from risk. The purpose of

group accounts is to present financial information about the activities of a parent charity and its subsidiary undertakings as a single entity and to show the resources controlled by the group, its obligations and the results achieved with its resources.

10. Larger charitable companies that are parent charities are required by company law to prepare group accounts and smaller parent charities are able to do so, on a voluntary basis. However, the threshold set for the preparation and audit of group accounts did not differentiate between charitable and commercial companies. The Charities SORP's recommendations, which set a lower threshold for the preparation of group accounts, are also generally applied by charitable companies.

11. The changes introduced by the 2006 Act were in response to a sector sponsored amendment to the Bill. Whilst the 2006 Act creates the requirement for group accounts, Regulations are required in order to provide a workable and practicable framework for both preparers and auditors of group accounts. The Regulations set out:

    - how to determine the aggregate gross income of the group for threshold purposes;
    - the threshold at which group accounts should be prepared and audited;
    - the form and content of group accounts, the methods and principles to be used in their preparation, information to be included by way of notes and the content of a group annual report;
    - the circumstances in which a subsidiary may or must be excluded from the group accounts;
    - dealing with differing financial years of group members and the duties of charity trustees of parent charities to secure that the financial years of group members coincide; and
    - an auditor's rights to information in relation to subsidiary undertakings.

12. The Regulations have built on the framework already provided for by the existing 2005 Regulations for individual accounts of charities. In dealing with consolidation methods and principles reliance has been placed on generally accepted accounting practice supplemented by the Charities SORP's recommendations. In this way both the length and complexity of the Regulations is reduced and ensures the Regulations accord with existing sector and recommended practice.

Background - Threshold for preparation and audit of group accounts

13. The Regulations require groups with an aggregate gross income of more than £500,000 net of consolidation adjustments to prepare group accounts. The Regulations also rely on the same threshold for the audit of group accounts.

14. It would clearly be illogical to require an audit of group accounts where there is no requirement for group accounts to be prepared and similarly to require the preparation of group accounts without the assurance provided by audit would limit the value of group accounts to users.

15. The threshold is also consistent with the Charities SORP which recommends the preparation of group accounts where the aggregate gross income of the group exceeds the audit threshold applying to an individual charity's accounts. This recommendation is generally applied by the charity sector.

16. The requirement for group accounts and group annual reports will affect all non-company parent charities where the "aggregate gross income" of the group exceeds £500,000 net of consolidation adjustments. Parent charities that are companies will be similarly affected,

except that where the parent charity exceeds the Companies Act's threshold for a small parent company its group accounts will continue to be prepared and audited under company law provisions.

17. Information provided to the Charity Commission by charities completing their annual returns indicates that 556 non-company parent charities and 1,257 company parent charities on its register will be affected by this requirement.

18. The group accounting requirements of the Regulations also apply to excepted charities but such charities are not required to produce a group annual report unless they are voluntarily registered or are directed by the Charity Commission to prepare an annual report. However, any excepted parent charities will be required to prepare a group annual report on loss of their excepted status if the aggregate income of the group exceeds the preparation threshold.

19. The Charity Commission estimates that there may be as many as 5,000 excepted charities with an income of more than £100,000. Of these 5,000 charities, it is estimated that there are 2000 armed forces charities and up to 2,000 Church of England PCCs. These charities only rarely make use of trading subsidiaries.

20. The remaining 1,000 excepted charities may on occasions make use of trading subsidiaries. Excepted charities are also usually non-company charities and if their income distribution follows the register income profile and their propensity to utilise subsidiary undertaking mirrors that of other registered non-company charities then some 80 excepted charities will be affected by the new group accounts and audit provisions.

21. Excepted charities are not required by the Regulations to prepare a group annual report. Following changes to be introduced by the Charities Act 2006 some charities that are currently excepted will be required to register. On registration the requirement to prepare a group annual report will apply at the same income threshold as for other registered charities.

22. Exempt charities are not affected by the Regulations as they are neither required to prepare group accounts nor a group annual report. Following changes to be introduced by the 2006 Act exempt which do not have an alternative principal regulator will be required to register. If their income distribution follows the register income profile and their propensity to utilise subsidiary undertaking mirrors that of other registered charities then some 150 exempt charities will be affected by the new group accounts and audit provisions.

Background - Trustees' group annual reports

23. The 2005 Regulations currently set out the content of a trustees' annual report accompanying the individual accounts of a charity and provide for a review of the activities of a charity. In addition, the annual report provides other information relating to the charity, its trustees or officers. Regulations are needed to ensure this framework remains relevant to the reporting needs of charities that prepare group accounts and the information needs of users of the group annual report and accounts.

24. The Charities SORP recommends that charities, which are subject to statutory audit, include in the trustees' annual report an explanation of the significant activities undertaken through subsidiary undertakings and a review of the achievements and performance of subsidiary undertakings. The Regulations build upon this recommended practice.

25. Accompanying information contained in the annual report is vital in explaining the numerical information contained in the accounts. It is therefore important, if this policy objective is to be maintained, for the annual report accompanying group accounts to also address the activities, achievement and policies of both the parent charity and the subsidiary

undertakings it controls.

26. The Regulations seek to build on the 2005 Regulations extending the report to the aims and objectives set for subsidiary undertakings, the strategies for achieving them and details of activities and achievement. In addition, key policy statements in relation to investment performance and policies, reserves and risk management are extended to include subsidiary undertakings.

Background - Reporting public benefit in the trustees' annual reports

27. The 2006 Act includes a statutory definition that, to be a charity, an organisation must have purposes which fall within the descriptions of charitable purposes listed in the 2006 Act and that these purposes must be for the public benefit.

28. In order to provide charity trustees with a mechanism to report on how they meet this public benefit requirement, the Regulations amend the existing requirements of trustees' annual report so it can be done as part of reporting a charity's activities and achievements.

29. The Regulations take forward proposals contained in the Charity Commission's consultation on its public benefit guidance. The Regulations take a proportionate approach that is consistent with the principle that small charities should not have the same regulatory requirements as larger ones. The Regulations also reflect the established principle that charities which are subject to audit are also subject to different levels of accountability and hence should provide more detailed information in their trustees' annual reports than those not subject to audit.

Background - Other Changes to the Regulations

30. There are other changes made by the 2006 Act to Part 6 of the 1993 Act which will involve some changes to the 2005 Regulations which are not considered to give rise to any significant regulatory costs or savings, and are therefore excluded from this assessment, these include:

    a. Providing for the reporting duties where an independent examination of a health service charity following the introduction the Regulatory Reform (National Health Services Charitable and Non-Charitable Trust and Accounts) Order 2005;

    b. A Regulation requiring an independent examiner to report qualifications held where the income of the charity exceeds £250,000;

    c. Deletion of the existing whistleblowing provision applying to auditors and independent examiners under the 2005 Regulations which are now provided for in the new section 44A of the 1993 Act; and

    d. A restriction of the existing disclosure of particulars of grants made in the notes to the accounts so that the requirements are compatible with the new section 42 (2A) of the 1993 Act which does not require the disclosure of details of institutional grants made by a charitable trust during the lifetime of a settlor or any spouse or civil partner of the settler.

Cost Calculations

The preparation and audit of group accounts and group annual reports

31. The new Regulations require parent charities with a group aggregate gross income of more than £500,000 net of consolidation adjustments to prepare group accounts.

32. It is recognised that some charities with a gross income of less than £500,000 also have subsidiary undertakings whose income when consolidated with that of the parent charity will take the group over the threshold for group accounts. It is estimated, based on an analysis of a sample of 300 sets of submitted group accounts that a parent charity's gross income is increased by 34 per cent, on average, following consolidation.

33. Based on Annual Return information provided by charities to the Charity Commission, adjusted for the income uplift described in the preceding paragraph, some 1,257 company charities will have a group income falling within the band £500,000 to £5,600,000. Above this income threshold company charities will generally fall within the company law requirements of the Companies Act which require all companies, including charities, that do not qualify as small to prepare group accounts under that regime.

34. Non-company charities are less likely to undertake activities through subsidiary undertakings. Annual return information provided by charities to the Charity Commission, adjusted as above, indicates that there are 556 non-company parent charities affected.

35. Excepted charities are also affected by the group accounts Regulations. Based on the assumptions explained in paragraphs 20 to 21 and assuming their income distribution mirrors that of registered charities some 80 excepted charities will be affected. The estimate number of excepted charities affected has been adjusted from the number estimated in the partial regulatory impact assessment consulted on as both PCC and Armed Services charities are unlikely to make significant use of group structures.

36. Currently exempt charities are not affected by the group accounts Regulations. However, many will have to register, when relevant provisions of the Charities Act 2006 come into effect. Using the same assumption set out in paragraph 22, it is estimated that some 150 exempt charities will be affected on registration.

37. The preparation of group accounts is now general practice within the charity sector and is an accounting recommendation of the Charities SORP. Group accounts are prepared by consolidating financial information contained in the individual accounts of the parent charity and all of its subsidiary undertakings. In the absence of minority interests, this process involves adjusting any profit and loss account of subsidiary undertakings into a Charities SORP format and a cross addition of each data field in the primary statements and notes to the accounts to arrive at a consolidated position. Adjustments are also made to eliminate intra-group transactions.

38. The Commission holds cost data on charity regulation that was prepared for it and the Government's Better Regulation Executive as part of the cross Government Administrative Burdens Reduction Project. The weighted average cost for the preparation of individual accounts and related notes was approximately £4,000 including both internal and external costs. It was estimated in the partial regulatory impact assessment that the preparation of group accounts would add some 25 per cent to these costs (or £1,000). However, consultation feedback suggested that this may slightly underestimate the additional costs of preparing consolidated accounts. The cost uplift has therefore been revised up to 34 per cent (or £1,360).

39. The preparation of group accounts is already general sector practice. The Charity Commission estimates that over 95 per cent of charities affected by the Regulations already prepare group accounts. This is supported by an analysis of submitted group accounts which found that 69 charities in a sample of 70 charities were already preparing group accounts at the threshold proposed in these Regulations. A study of regulatory costs undertaken for the Cabinet Office's Better Regulation Executive as part of the cross Government Administrative Burden Project concluded that a "business as usual" discount of 95 per cent should be applied to the preparation of

individual charity accounts and it is considered that parallel argument apply in the context of group accounts for a similar discount. The "business as usual" elements of costs arise where a particularly regulatory cost can be discounted because the requirement of regulations is usual sector practice and would be undertaken irrespective of regulatory requirements.

40. On this basis the estimated regulatory costs for the preparation of group accounts are:

Income Band	**Company parent**	**Non-company parent**	**Total number of charities**	**Total cost £**
£500,00 to £5,600,000	1,257	361	1,618	2,200,480
Over £5,600,000	N/A	195	195	265,200
Excepted and exempt	N/A	230	230	312,800
Total	**1,257**	**786**	**2043**	**2,778,480**
Less Business as usual element (BAU) 95 per cent	-	-	-	(2,639,556)
Total (after BAU)	**-**	**-**	**-**	**138,924**

41. The Regulations will also require the group accounts prepared to be audited. The audit opinion is expressed on the aggregated figures contained in the primary statements of the group accounts. Where the individual accounts of the parent charity and those of its subsidiaries have been audited then further audit work on the individual accounts is likely to be limited. Audit work will be necessary to ensure the individual accounts are correctly aggregated and checks will also normally be necessary to ensure intra-group transactions and balances are properly eliminated on consolidation and that accounts are presented in accordance with the relevant statutory framework.

42. These additional audit costs will normally be borne by the parent charity. It was estimated that these procedures would add up to 25 per cent to the audit costs currently met by parent charities in relation to their individual accounts, although it should be noted that charities preparing group accounts following the Charity SORP's recommendations are already generally obtaining audit opinions on their group accounts. However, that uplift has been increased to 34% for non company parent charities following consultation feedback. Parent company charities that exceed the Company Act 2006 threshold for small parent companies will not require an audit of their group accounts under the 1993 Act as they are already subject to an audit requirement under company law.

43. As described in paragraph 38, the Commission holds data on charity regulation. The weighted average cost for audit was £8,800. This may include the audit of group accounts when prepared but such costs, if any, cannot be separately identified and therefore have been ignored and may result is some overestimation of additional audit where group audit costs are already included in data).

44. The Companies Act 1985 effectively required the audit of company charities where the group income exceeded £350,000 net (or £420,000 gross) of consolidation adjustments. However, for non-company charities it could be argued that some audit work will be required on subsidiaries that do not themselves have to be audited under statute in order to form an opinion on the group. The Charities Act does not require a separate audit report to be prepared in respect of subsidiaries unless the subsidiary itself is a charity and above the charity audit threshold. We have therefore increased the uplift from 25 per cent to 34 per cent to reflect the potential additional audit work

required on some subsidiaries. The average additional audit cost for a company parent charity is estimated at £2,200 of which 95% is again regarded as business as usual cost reflecting existing sector practice in relation to the audit of group accounts.

45. The average additional audit cost for a non company parent charity is estimated at £2,992 of which 95% is again regarded as business as usual cost reflecting existing sector practice in relation to the audit of group accounts.

Group Income Band	**Company parent**	**Non-company parent**	**Total number of charities**	**Total cost £**
£500,000 to £5,600,000	1257	N/A	1257	2,765,400
£500,000 to £5,600,000	N/A	361	361	1,080,112
Over £5,600,000	N/A	195	195	583,440
Excepted and exempt	N/A	230	230	688,160
Total	**1,257**	**786**	**2,043**	**5,117,112**
Less Business as usual element	-	-	-	(4,861,256)
Total (after BAU)	**-**	**-**	**-**	**255,856**

46. Registered charities are already required by the 2005 Regulations to prepare an annual report on their own activities. These requirements however do not currently extend to providing information about the activities or policies of subsidiary undertakings although this extension of the trustees' annual report is general sector practice where group accounts are prepared.

47. The work involved in preparing a group annual report is primarily collation of existing information currently reported in a charity's individual annual report and those of its subsidiary undertakings. For example, subsidiary undertakings that are companies will prepare a directors' report.

48. The cost data held by the Commission (see paragraph 38) identifies the average regulatory cost (i.e. excluding costs which would have been incurred regardless of regulation, known as Business as Usual Costs) for a charity preparing an annual report in the income band £500,000 to £1,000,000 as £552 per charity and £537 above this threshold. For the purposes of this assessment, a standard cost of £550 has been used. This data has been used to estimate the additional costs likely to be involved in adding information relating to subsidiary undertakings to an annual report as currently required.

49. Although the level of activities carried out though subsidiary undertakings can vary significantly, sample data indicates that typically subsidiary undertakings account for a quarter of a group's income. On this basis, it has been assumed that providing additional information about subsidiary undertakings within a group annual report will increase the costs of preparing an annual report of a parent charity by 25 per cent, that is, £137.50.

50. Neither exempt nor excepted charities are required to prepare either individual or group annual reports. However excepted charities and certain exempt charities will be required to register in 2008 following changes introduced by the 2006 Act. Assuming these charities follow the profile of other

charities currently registered then a further 230 charities will be affected on their registration.

Group Income Band	**Company parent**	**Non-company parent**	**Total number of charities**	**Total cost £**
£500,000 to £5,600,000	1257	361	1618	222,475
Over £5,600,000	N/A	195	195	26,812
Excepted and exempt	N/A	230	230	31,625
Total	**1257**	**786**	**2043**	**£ 280,912**

51. On consultation two respondents suggested that the costs of training or familiarisation should be reflected in the costs of preparation of group accounts and group annual reports. An indicative costing has been prepared using estimated cost estimates from the Annual Survey of Hours and Earnings collected by the Office of the National Statistics with a standard 30 per cent uplift for overheads. As the preparation requirement reflects existing sector practice, we have estimated that a further 2 hours training or familiarisation is realistic. This has been costed at the "internal professional" rate of £23.40 per hour. On that basis, the training and familiarisation costs for the 2,043 charities that will be required to prepare group accounts is estimated to be £95,612.

52. The regulatory costs resulting from the Regulations relating to the introduction of the group accounts requirements, excluding business as usual costs, are summarised below:

Cost element	**Total cost**
Preparation of group accounts and related notes to the accounts	£**138,924**
Audit of group accounts	£**255,856**
Group annual reporting	£**280,912**
Training and familiarisation (first year only)	£95,612
Total	**£771,304**

Reporting public benefit in trustees' annual reports

53. The Regulations will involve charity trustees giving consideration to the public benefit guidance published by the Charity Commission and setting the currently required explanation of main activities in the context of charitable purposes for the public benefit. Given the statutory requirement that a charity's purposes must be for the public benefit, consideration of a charity's purposes is inherent in a trustee's duties and therefore no additional compliance cost should arise from the simple confirmatory statement required. Similarly, the minor refocusing of information already provided in the trustees' annual report is unlikely to give rise to any additional regulatory costs. However the review of charity law thresholds, published for consultation in December 2007 recommends an increased threshold for the preparation of a Trustees' Annual Report.

54. Most consultation respondents agreed that it was important for charities to demonstrate that they are furthering their purposes for the public benefit, and that the most cost effective way of doing so would be through the trustees' annual report. Several respondents were concerned to avoid adding to charities' regulatory burden, and some questioned the need for charities to report on their public benefit at all. The requirement in the regulations simply places the reporting of the charity's main activities and achievements in the context of furthering the charity's purposes for the public benefit. It does not require charities to explain *how* the charity's activities or purposes are for the public benefit.

Auditable charities with income of £1 million or less:

55. The costs data held by the Commission (see paragraph 38) has identified the average regulatory cost (i.e. excluding costs which would have been incurred regardless of regulation, known as Business as Usual Costs) for a charity in this income bracket preparing an annual report as £552 per charity.

56. It is estimated that there will be an initial 20% to 25% increase in regulatory costs for charities in this income group from the Regulations, falling to 10% to 15% from year two onwards.

57. There are 3,400 registered charities in this income group, giving an additional cost of between £375,000 and £469,000 in year one and £188,000 and £282,000 in subsequent years.

58. It is estimated that 1,000 charities currently exempt and excepted charities that will have to register, when relevant provisions of the Charities Act 2006 come into effect, will fall within this income band. Assuming a similar cost structure these proposals would add a further £110,000 to £138,000 in year one and £55,000 to £82,500 in subsequent years.

Charities with an income of over £1 million:

59. Costs data held by the Charity Commission (see paragraph 38) identify the average regulatory cost (i.e. excluding Business as Usual Costs) for a charity of this size preparing a trustees' annual report as £537.

60. Again, it is estimated that in the first year of the new public benefit requirement coming into effect there will be a 20% to 25% increase in regulatory costs for charities in this income group, falling to 10% to 15% from year two onwards.

61. There are 5,230 registered charities in this income group, giving an additional cost of between £562,000 and £702,000 in year one and £281,000 to £421,000 in subsequent years.

62. It is estimated that 1,500 charities currently exempt and excepted charities that will have to register, when relevant provisions of the Charities Act 2006 come into effect, will fall within this income band. Assuming a similar cost structure these proposals would add a further £161,000 to £201,500 in year one and £80,500 to £121,000 in subsequent years.

63. The following table shows a summary of additional reporting costs for charities:

Category	**Year one costs**	**Subsequent annual costs**
Registered charities with an income between £500, 000 and £1 million (3,400)	£375,000 to £469,000	£188,000 to £282,000
Currently excepted or exempt charities with an income between £500,000 and £1 million (1,000)	£110,000 to £138,000	£55,000 to £83,000
Registered charities with an income above £1 million (5,230)	£562,000 to £702,000	£281,000 to £421,000
Currently except or exempt charities with an income above £1 million (1,500)	£161,000 to £202,000	£81,000 to £121,000
Totals	**£1,208,000 to £1,511,000**	**£605,000 to £907,000**

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	N/A	N/A
Small Firms Impact Test	N/A	N/A
Legal Aid	N/A	N/A
Sustainable Development	N/A	N/A
Carbon Assessment	N/A	N/A
Other Environment	N/A	N/A
Health Impact Assessment	N/A	N/A
Race Equality	N/A	N/A
Disability Equality	N/A	N/A
Gender Equality	N/A	N/A
Human Rights	N/A	N/A
Rural Proofing	N/A	N/A

Annex - Summary of the Consultation & Changes made to the Regulations following consultation

1. This section sets out the process of consultation that was carried out on draft Regulations, the responses that were received to that consultation, and changes made to the Regulations as a result.
2. In 2007 the Office of the Third Sector undertook a 13-week public consultation on the proposed changes to be made by the draft (Charities Act 2006 (Charitable Companies Audit and Group Accounts) Provisions Order 2008) and the draft Charities (Accounts and Reports) Regulations. The consultation was sent to over 1,000 individuals through a variety of mechanisms, including the Charities Act implementation e-mail group 800+), targeted mailing or e-mails were sent to sector technical experts, professional bodies and advisers, umbrella groups, and those who expressed an interest in the Charity Commission's public benefit consultation.
3. In all, 86 responses were received. Most respondents (60) responded only to the changes to the regulations in relation to reporting public benefit in the Trustees' Annual Report. 71 respondents replied to the questions on reporting public benefit. In addition, several respondents did not address the questions about reporting public benefit, but raised wider issues around the concept of public benefit and its applicability to particular types of charity.
4. Respondents included charity umbrella bodies, charities, charity trustees, professional bodies, lawyers, accountancy professionals, consultants, public bodies, an academic, and members of the public. A significant number of responses on the questions around reporting public benefit were from religious charities, their umbrella bodies, or individuals expressing concern about how the proposals might affect religious charities.
5. 15 of the respondents commented on the proposals in the section 77 Order to harmonise accounts scrutiny requirements and group accounts requirements for small charitable companies, which are addressed in a separate impact assessment on the section 77 Order. However, none of those respondents opposed the policy objective of unifying the accounts scrutiny requirements for small non-company and company charities, and were generally supportive of the harmonisation of group accounts preparation and scrutiny. For completeness, the responses in relation to the section 77 Order are included here.

The preparation and Scrutiny of Groups Accounts

6. The Charities Act 2006 introduces a statutory requirement for the preparation and scrutiny of group accounts by non-company charities where the group's income is above a certain threshold. The requirements for the form and content of the group accounts, related notes to the group accounts, and the group annual report are provided for by the Regulations. The Regulations also provide for the financial threshold above which group accounts must be prepared, and the threshold above which they must be scrutinised, as well as the duties of auditors in relation to the scrutiny of group accounts.

Q1: Do the requirements for the form and content of group accounts and related notes to the group accounts provided by the draft 2007 Regulations provide a sufficiently robust framework for their preparation?

Q2: If not, how might the draft 2007 Regulations be strengthened to provide a workable framework for their preparation?

7. The 1993 Act was, until new measures were introduced by the 2006 Act, based on the premise that charities produce entity or individual accounts. Individual accounts reflect the transactions undertaken directly by the charity and the assets that it can control directly.

8. Charities are becoming increasingly sophisticated in the structures that they adopt to undertake their charitable activities and to generate income. Increasing use is being made of trading subsidiaries to undertake income-generating trades. The separation of such trades into a subsidiary undertaking controlled by the charity allows profits to be transferred to the parent charity through gift aid arrangements allowing charities to receive such income free of income or corporation tax. Other charities will choose to conduct certain of their charitable activities through subsidiaries to help isolate the charity from risk or to enable activities to be undertaken overseas.

9. The presentation of individual accounts may therefore only reflect part of a charity's wider activities and resources it controls and deploys. Activities and resources indirectly controlled through subsidiary undertakings are omitted from individual accounts and are simply disclosed as investments in the charity's balance sheet. Consolidated or group accounts attempt to present a picture of the charity and its subsidiary undertakings as an economic unit enabling users of accounts to appreciate the wider aspects of a charity's work and the resources it deploys indirectly through a group structure.

10. Accounting Standards (Financial Reporting Standard 2: Accounting for subsidiary undertakings) endorse this accounting approach as necessary to present a true and fair view of the group. The Charities SORP, which must be consistent with accounting standards, reflects this and recommends that all parent charities with an aggregate group income above the individual charity audit threshold should produce group accounts. The preparation of group accounts is now generally accepted sector practice.

11. The policy objective for the Regulations for group accounts is to ensure a workable framework for their preparation and audit and to do so as economically as possible in terms of the requirements introduced. Wherever possible the draft Regulations built on the framework already provided for by the existing 2005 Regulations for individual accounts of charities. In dealing with consolidation methods and principles reliance was placed on generally accepted accounting practice supplemented by the Charities SORP's recommendations.

12. There were 13 responses to the first question. 12 respondents (92%) agreed that the draft regulations provided a sufficiently robust framework for the preparation of group accounts. One respondent disagreed, and several respondents offered suggestions for improving the framework.

13. One respondent pointed out that for a company charity to be exempt from audit under the Companies Act it must contain a statement to that effect on its balance

sheet. The respondent also felt it would be unusual for such a statement to be made whilst an audit might be required under the Charities Act and questioned the benefits of audit under the Charities Act rather than the Companies Act. It was also pointed out that a charity preparing its accounts under the Charities Act may be prevented from publishing such accounts as its annual accounts without a Companies Act auditors' report.

14. We have given consideration to these issues in finalising the Regulations. The Commission has indicated that it will publicise in its guidance and examples the requirement for a Companies Act audit exemption statement to be provided where a charity's individual account are audited under the Charities Act. The policy objective is to remove small charitable companies from the scrutiny regime of the Companies Act so that the same external scrutiny arrangements apply to charities of the same size however constituted. Our view is that a charitable company which is exempt from a Companies Act audit requirement is not prohibited from publishing its statutory accounts but we will remind charities that wish to use group accounts for Companies Act purposes that the accounting requirement of that Act must also be met.

Q3: Do you agree that the threshold set for the preparation of group accounts should be identical to that set for the audit of group accounts, and that the scrutiny should always take the form of an audit?

Q4: Do you consider the draft 2007 Regulations set a reasonable threshold for the audit of group accounts? If not, what threshold do you believe to be appropriate and why?

15. The draft Regulations provided for the threshold at which group accounts should be prepared and scrutinised. These thresholds could be set independently at differing amounts, and it would be possible to provide for the independent examination rather than audit of group accounts in some cases. However, the policy preference was that the same threshold should apply to both the preparation and scrutiny of group accounts, and that the scrutiny should always take the form of an audit. To ask charities to prepare group accounts without the assurance offered by audit would limit their usefulness to users and it would clearly be impracticable to ask for their audit in the absence of their preparation. The approach proposed was also consistent with the Companies Act 2006 where the audit threshold for individual accounts is the same as the group accounts preparation and audit thresholds.

16. Of the 14 respondents to question 3, only one disagreed with the proposals. However, three respondents did not agree that the scrutiny of group accounts should always take the form of an audit. They argued that independent examination by a qualified independent examiner would reduce the costs of scrutiny for small charity-headed groups. One respondent also questioned why the preparation and scrutiny thresholds were linked.

17. Our policy view remains that these two thresholds should be linked. If the preparation threshold was below that set for scrutiny then no assurance would be provided on those accounts. Clearly, scrutiny could not be required in the absence of the requirement for such accounts to be prepared. In so far as current sector practice, supported by SORP recommendations, is for group accounts to be prepared where aggregate group income exceeds £500,000 the introduction of an independent examination regime would have only been possible if the threshold at

which group accounts are to be prepared was reduced (adding to regulatory costs). It would be untenable to require audit for individual entity accounts at an income of £500,000 and yet allow independent examination of more complex group accounts at the same threshold. The introduction of an independent examination regime would have involved the introduction of a lower threshold for preparation which would have resulted in legal requirements being more onerous than current best practice recommendations followed by the sector.

18. The Charities SORP currently recommends the preparation of group accounts where the gross income of the group exceeds the audit threshold applying to an individual charity's accounts. This recommendation is generally applied by the sector. The use of the charity audit threshold also prevents the creation of subsidiary undertakings simply to avoid audit and addresses the need for audit by considering the size of the group rather than simply that of the parent charity.

19. Public accountability points towards a lower audit threshold applying to charity groups than for private commercial groups. This principle already applies to individual accounts of charities. For example, the Companies Acts' current turnover threshold for audit exemption of commercial companies is £5,600,000, whilst the corresponding threshold for charities is annual income of £500,000 following measures introduced by the 2006 Act.

20. In weighing up these considerations the draft Regulations proposed a common threshold for both the preparation and audit of charity group at an aggregate gross income of £600,000 before consolidation adjustments and £500,000 net of consolidation adjustments.

21. 13 responses were received to question 4. 85% (11) of respondents agreed with the proposed group accounts preparation and audit thresholds. Two disagreed. One suggested an audit threshold of £1M gross income as being more appropriate for group accounting and scrutiny, as this aligns with the requirement for charities to produce a Summary Information Return.

22. Legal vires has resulted in a minor change in that only a single threshold may be prescribed in law. The threshold for the preparation and scrutiny of group accounts has therefore been amended to situations where aggregate gross income exceeds £500,000 net of consolidation adjustments. We also continue to take the view that the assurance provided by audit is the appropriate type of scrutiny for group accounts. The audit threshold for charities (both company and non-company was increased in 2007 from £250,000 income to £500,000 income).

23. In 2007 the Office of the Third Sector and the Charity Commission undertook a review of all the financial thresholds in the Charities Acts, and a public consultation in currently underway on the recommendations of that review. Whilst there is no formal recommendation to increase the audit threshold for charities, consultees are asked whether the current audit threshold of £500,000 income (or £2.8M assets) is appropriate for scrutiny of charities, or whether a higher threshold should apply. We would reconsider the group accounts preparation and audit thresholds in the light of any recommendation to change the audit threshold for individual charities.

Q5: In the context of a group which contains a non-charitable subsidiary undertaking should aggregate gross income be calculated by reference to that

subsidiary's turnover, or by reference to those items of income or gains that would be construed as gross income in charity accounts?

24. The draft Regulations defined "aggregate gross income" of a charity group for the purposes of the group accounts preparation threshold by reference to the aggregate of the parent charity's gross recorded income and that of any subsidiary undertaking that is a charity (both calculated using the existing statutory definition of gross income) and by reference to the turnover of any non-charitable subsidiary undertaking. The turnover definition was based on that in section 474 Companies Act 2006. An alternative approach would be to define aggregate gross income, in the context of a non-charitable subsidiary, not by reference to its turnover but rather by reference to those items of income or gains that would be construed as gross income in charity accounts. This creates greater consistency but would result in an additional calculation before aggregate gross income of a group could be determined.

25. There were 13 responses to this question. Five respondents (38%) favoured reliance on the turnover of a non-charitable subsidiary for determining the aggregate gross income of the group. Six respondents (46%) were in favour of the alternative approach, relying on those items of income or gains in a non-charitable subsidiary that would be construed as gross income in charity accounts. Two respondents (16%) considered either approach satisfactory. We considered the responses and the two options in depth, as opinion was more divided on this question than in response to any of the other questions in the consultation.

26. Some of the arguments put forward for favouring the "gross income" approach as opposed to the turnover approach were convincing. One respondent suggested that very little effort was required to augment turnover by what in some cases could be very significant non-trading income (such as investment/deposit interest or rental/licensing/royalty income) to arrive at the "gross income" of the non-charitable trading subsidiary. One respondent argued that by relying simply on the turnover of non-charitable subsidiaries there might be a temptation for trustees to avoid group accounts preparation and scrutiny by establishing a small core charity and then carrying out its charitable activities through a non-charitable subsidiary. The arguments in favour of using the turnover approach were that the directors of non-charitable companies within a charity headed group will, in any case, need to assess their turnover in order to comply with company law obligations. Using turnover for the purpose of determining the contribution of the company to "aggregate gross income" has the merit of simplicity.

27. However, we are uncomfortable about potentially quite large income sources, not construed as turnover by a subsidiary company, being omitted from the calculation. It also feels uncomfortable to have a situation where if group accounts were prepared the accounts would suggest the income threshold was exceeded but in law it would not have been exceeded because certain items of income (disclosed as income in group accounts) not forming turnover in the subsidiary were excluded from gross income for group accounts preparation threshold purposes. Such an approach would also be out of line with the charities SORP (paragraph 383 (b)) and we have placed some store on being consistent with recommended practice.

28. Therefore, the Regulations require that non-charitable subsidiaries calculate their gross income as the amount of their income that would be construed as its gross

income were it a charity. This introduces consistency in that all subsidiaries will now calculate gross income on the same basis as the parent charity and charitable subsidiaries.

Q6: In general, do you consider that the draft 2007 Regulations provide a workable framework for the preparation and audit of group accounts? Do you have any suggestions as to how the Regulations relating to group accounts might be improved?

29. The introduction of group accounts into charity law necessitates the extension of a number of provisions that currently apply to individual accounts and their audit to group situations. Issues such as defining financial years, situations where subsidiary undertakings may or must be excluded from consolidation and auditors rights to information all need to be addressed. Again, the policy aim has been to be as concise as possible whilst ensuring that a workable framework is put in place. Where possible and appropriate the draft Regulations mirrored corresponding provisions of the Companies Act 2006.

30. In relation to group accounts, the existing audit reporting duties applying to a charity's individual accounts are extended so as to give an opinion on the group accounts prepared for a parent charity and its subsidiary undertaking(s).

31. Of the 11 respondents to this question, 9 (82%) either agreed or partly agreed that the draft Regulations provided a workable framework for the preparation and audit of group accounts. One respondent had already disagreed with earlier questions on the preparation of group accounts, the proposal that they should undergo audit and the proposed thresholds – their response to this question referred to their earlier objections. The other respondent who disagreed with the statement argued that the burden of audit for group accounts would fall upon charities that are effectively small but have some subsidiaries with commercial turnover that pushes them above the audit threshold inappropriately, which could add excessively to their compliance costs. One respondent argued that the Charity Commission should have the power to dispense with the requirement for independent examination in exceptional circumstances.

32. The policy objective for group accounts is to ensure that all activities and resources including those controlled through subsidiary undertakings are reflected in the accounts. It is recognised that some charities may undertake the majority of their activities through subsidiaries and therefore it is necessary to ensure the threshold for the audit of group accounts is based on the aggregate income of the group notwithstanding the fact this may on occasions place an audit requirement on a parent non-company charity where non previously existed for the parent entity's own accounts.

33. Feedback from the Commission indicates they cannot envisage a situation where total exemption from independent examination would be desirable. Exemptions from audit can be provided exceptional circumstances and also where other scrutiny regimes provide similar assurance.

Charity law scrutiny of small charitable companies

34. The commencement of section 1175 and schedule 9 of the Companies Act 2006 and the section 77 Order will make further changes for small charities that are companies, bringing their external scrutiny regime into line with that of unincorporated charities. For these purposes small company charities are those charities constituted as companies under the Companies Acts which are not required to have their accounts audited under company law.

35. Until now for smaller charities (i.e. those below the professional audit threshold) different arrangements apply depending on whether the charity is a company or not.

36. For small charities that are companies, if gross income exceeds £90,000 but not £500,000 and the balance sheet total is not more than £2.8m, the directors may have a report prepared on the accounts by a reporting accountant. If they do that the company is exempt from the audit requirement. Where the gross income is below £90,000, no scrutiny at all is required unless the balance sheet total threshold is exceeded.

37. For non-company charities, the gross income threshold for audit is £500,000, and an asset threshold is introduced of £2.8m for charities with an income between £100,000 and £500,000. Where the gross income of the charity is below £10,000 then no scrutiny at all is required. If gross income exceeds £10,000 and the audit thresholds are not exceeded, the trustees may elect for an examination by an independent examiner in place of an audit. Additionally, charities with a gross income over £250,000 that are not otherwise required to have a professional audit must have their accounts examined by an independent examiner from a recognised professional body.

38. The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 (SI 527) will bring small company charities into the scrutiny regime of Part 6 of the 1993 Act from 1 April 2008. This will address a long standing sector concern about the inconsistencies between the external scrutiny arrangements applied by the Companies Act to smaller company charities and those applied by the 1993 Act to non-company charities. The extension of the accounts scrutiny regime in Part 6 to the individual accounts of small charities that are companies creates a need for the new accounting and reporting Regulations to address the reporting duties of auditors and independent examiners of small company charities.

39. In relation to the audit and examination of the individual accounts of small company charities, the policy approach has been to apply those duties that currently apply to non-company charities, modified, in so far as necessary, to recognise the company law framework applying to their preparation.

40. The Order does not make any provision for exempt charities. One effect of the Companies Act 2006 amendments will be to remove the “charity” accounts scrutiny provisions which currently apply to all charities that are companies, including exempt charities, and replace them with the general company law audit regime. The effect will be that small charities that are companies and are exempt charities will be, as regards accounts scrutiny, in the same position as exempt charities that are non-charitable companies. This means that there will be no requirement for accounts scrutiny at all unless the company is over the general company audit threshold. This is because the proposals to apply the accounts scrutiny provisions of Part 6 of the 1993 Act to smaller charitable companies do not apply to exempt

charities. However, we understand that there are very few companies that are exempt charities and so it was decided that the Order should not make provision for these charities.

Q7: Do you agree with the approach proposed in the draft section 77 order for bringing small charities that are companies into the scrutiny regime of Part 6 of the 1993 Act?

Q8. Do the draft 2007 Regulations provide an appropriate framework for the reporting duties of auditors and independent examiners of small company charities' accounts? If not, how might they be improved?

Q10: Small charities that are companies, but which are also exempt charities are excluded from the draft section 77 order. Does that present any particular problems?

41. 15 of the respondents commented on the approach proposed in the draft order. None opposed the policy objective of unifying the accounts scrutiny requirements for small non-company and company charities.

42. One respondent suggested that this order offered a de-regulatory opportunity to raise the threshold for independent examination of charities' accounts. The current income threshold is £10,000. One impact of this order will be that charitable companies with an income between £10,000 and £90,000 will become subject to the requirement for independent examination of their accounts. However, evidence indicates that 85% of charities in that group already voluntarily have their accounts independently scrutinised, so the impact is not considered to be very significant. There are 6,234 company charities with an income between £10,000 and £90,000. Of those figures suggest that 85% (5,300) undergo some form of independent accounts scrutiny as a matter of best practice. So the requirement will be new, only for 934 company charities. If the 85% distribution is constant throughout the income range, there would be only 270 charitable companies with an income of between £10,000 and £25,000 that would be affected.

43. In 2007 the Office of the Third Sector and the Charity Commission undertook a joint review of all financial thresholds in the Charities Acts, and in December 2007 published for consultation a series of de-regulatory proposals to simplify and raise various thresholds. One recommendation was to increase the independent examination threshold from £10,000 to £25,000. The consultation is due to run until 31 March 2008, and is available on the website of the Office of the Third Sector.

44. Two of the respondents made the point that the interaction between this order, the Companies Act 2006 and Charities Act 2006 was complex, and that it would be helpful to users of the legislation to be able to refer to a consolidated version of Part 6 of the Charities Act 1993 as it will be once this order, and the relevant provisions of the Charities Act 2006 and Companies Act 2006 have been commenced. The Office of the Third Sector accepted this point, and has published a consolidated version of Part 6 of and Schedule 5A to the Charities Act on its website, prior to commencement of the provisions.

45. Of the 12 respondents to question 8, none felt that the framework for the reporting duties of auditors and independent examiners of small company charities' accounts

was inappropriate, although two respondents did offer suggestions for improving the framework. One respondent argued that all charity accounts subject to independent examination should be required to be examined by an independent examiner who is a member of one of the professional bodies listed in the Order, rather than just those with an income in excess of £250,000. We continue to believe that such an approach would be too onerous on small charities.

46. Of the 11 respondents to question 10, all but one (91%) considered the approach taken did not cause any particular problems in relation to exempt charities. No respondents provided examples of exempt charities constituted as companies.

Charity law scrutiny of small charitable company headed groups

47. The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 will extend the application of the new group accounting provisions to those parent charities which are companies but which are not required by company law to prepare group accounts. In relation to group accounts of a parent charity that is a company, the existing reporting duties of auditors as applied to the individual accounts of charities are extended so as to give an opinion on the group accounts prepared for a parent charity and its subsidiary undertaking(s).

Q9: Do the draft 2007 Regulations provide an appropriate framework for the reporting duties of auditors of group accounts for parent charities that are companies? If not, how might they be improved?

48. There were 10 responses to this question. Nine respondents agreed that the draft Regulations provided an appropriate framework for the reporting duties of auditors of group accounts for parent charities that are companies. One respondent referred to their argument from questions 1-3 that all charitable companies should be required to be audited under company law and charity law regardless of their size. Several respondents queried whether auditors or Independent Examiners would need access rights to subsidiaries in order to determine whether the group accounts threshold had been exceeded – requiring a full audit rather than independent examination.

49. The objective of the section 77 order is to bring the group accounts of small company parent charities into the audit framework provided by the Charities Act. This approach is still favoured rather than maintaining the existing need for special provision to be made within the Companies Act for charities and groups headed by charitable parent companies. We believe that trustees of parent charities are very unlikely to withhold copies of their accounts from independent examiners who are already given information rights in relation to records which relate to the charity and are considered by the examiner necessary for the purposes of carrying out their examination.

Trustees' Annual Reports – Group accounts

50. The current 2005 Regulations set out the legal requirements for the Trustees' Annual Report which are supplemented by the more detailed recommendations and guidance provided by the Charities SORP.

51. The annual report provides details of the aims and objectives set by a charity for the reporting year, together with details of the strategies adopted and significant activities undertaken to achieve those aims and objectives. It provides details of the achievements of the charity during the year, measured by reference to the aims and objectives set by the charity. In so doing it meets a key policy aim of enhancing accountability of charities to donors, beneficiaries and the general public.

52. Charities are increasingly undertaking activities to further both their charitable objectives and to raise funds through the use of subsidiary undertakings. The preparation of group accounts provides information on activities undertaken and resources controlled by a parent charity through subsidiary undertakings. Accompanying information contained in the annual report is vital in explaining and giving context to the numerical information contained in the accounts. It is therefore important, if this policy objective is to be maintained, for the annual report accompanying group accounts to also address these key issues in the context of the activities of both the parent charity and the subsidiary undertakings it controls.

53. The draft Regulations sought to achieve this policy aim by the introduction of a new Regulation 18. In addition to the information required in relation to the parent charity set out in Regulation 16, further information would be required in relation to the significant activities of subsidiary undertakings. The focus remains on the aims and objectives set for subsidiary undertakings, the strategies for achieving them and details of activities and achievement. In addition, key policy statements in relation to investment performance and policies, reserves and risk management would be extended to include subsidiary undertakings.

Q11: Do the draft 2007 Regulations provide an appropriate focus within the group annual report to enable trustees to explain the aims and objectives set for subsidiary undertakings and to explain the strategies adopted and activities undertaken to achieve them?

Q12: Do the draft 2007 Regulations create an appropriate balance between providing relevant information about activities conducted through subsidiary undertakings and the regulatory cost of providing such information? If not, what provisions might be added or removed?

54. 12 responses were received to question 11. Eight respondents (67%) agreed with the proposals in the draft Regulations for the preparation and content of the group Annual Report. Three respondents (25%) disagreed, arguing that the requirements for the preparation of the Trustees' Annual Report in the draft Regulations were too prescriptive. Two felt that reliance on the Charities SORP would be sufficient. One respondent was uncertain whether the draft Regulations would require the significant activities of subsidiaries to be reported on in aggregate or whether each subsidiary would need to be reported on separately. Another respondent considered that a single uniform narrative would be more appropriate, as under the draft Regulations they considered that wholly immaterial subsidiaries would be caught.

55. There were 12 responses to question 12. Eight respondents (75%) either agreed or partly agreed that the draft Regulations created an appropriate balance between providing relevant information about activities conducted through subsidiary undertakings and the regulatory cost of providing such information, although several

offered comments for improving them. Four respondents (25%) expressed concern that the requirements to prepare a group annual report were overly onerous.

56. Whilst it would be possible for the Regulations to adopt the requirements of the Charities SORP in full at present we favour an approach whereby the law provides for minimum requirement which can be expanded and developed by best practice recommendations contained within the SORP. The Regulations are consistent with the SORP but not as detailed. The report covers both the activities of the charity and its subsidiaries and the Regulations make it clear that the focus should be on the main or significant activities undertaken. The annual report adds significant value to the numerical information provided by the accounts. The information sought in the annual report is likely to be readily available and often the entities included within the group accounts will have prepared a report on their own activities. For these reason the preparation of a group annual report is not considered overly onerous.

Reporting Public Benefit

57. The 2006 Act restates the requirement that all charities must have charitable purposes which are for the public benefit, and the Act removes the long-standing presumption that education, poverty and religion charities are for the public benefit, creating a level playing field for all charities. The draft Regulations included provision for charities to set out, within the Trustees' Annual Report, the activities undertaken to further its purposes for the public benefit, and to confirm that the charity trustees had regard to the Commission's guidance on public benefit where it was relevant.

58. The draft Regulations issued for consultation redefined what is required in the Trustees' Annual Report to include information about the activities of the charity undertaken to further its purposes for the public benefit. The trustees of charities below the audit threshold, that is, charities with an annual income below £500,000, would be asked to include a brief summary of the main activities which were undertaken by the charity in order to further its purposes for the public benefit during the year. Trustees of charities above the audit threshold would be asked to provide a more detailed account, in the form of a review of significant activities which the charity undertook during the year in order to further the charity's purposes for the public benefit.

59. Under the proposals, all charities which must prepare an annual report would be required to confirm that the charity trustees have had regard to the Commission's guidance on public benefit where it is relevant.

60. Charity trustees already provide information in their annual reports which describes the activities and achievements of the charity, and this should be set in the context of furthering the charity's purposes for the public benefit. Many charities are already starting to use their annual report to address the issue of how the charity's purposes benefit the public. Relying on refocusing this part of the Trustees' Annual Report would minimise the regulatory burden for charities whilst ensuring that their activities to further their purposes for the public benefit were publicly reported.

Q13: Do you agree that it is appropriate for charities to report publicly how they meet the public benefit requirement?

61. 70 responses were received to this question. 75% of respondents agreed, or partly agreed that it is appropriate for charities to report publicly how they are for the public benefit. 12% of respondents did not think it appropriate for charities to report publicly how they meet the public benefit requirement, whilst a further 14% of respondents believed that the requirement should not apply to particular types of charities – either due to their size (small charities) or their purposes or activities (religious charities, charities providing benefits to a narrowly focused beneficiary group where there may be very limited public interest).

62. Several respondents were unclear whether the draft Regulations would require trustees to simply list their activities and achievements in the context of furthering the charity's purposes for the public benefit, or whether the charities would have to explain *how* their activities or purposes were for the public benefit. The first approach would not be significantly different from what is currently required in the Trustees' Annual Report, but would ensure that the reporting of activities was placed in the context of public benefit. The second approach would be significantly more onerous for charities, as they would have to explain how their activities benefit the public. For some charities – particularly small charities, and charities where public benefit may not be so obvious or tangible – this was seen to be potentially very burdensome.

63. Some respondents questioned the terminology of the draft regulations, and in particular the use of the phrase "for the benefit of the public" in relation to charities' activities. This was felt to be confusing, as the public benefit requirement in the Charities Act relates to a charity's purposes, not its activities. There was concern that the draft Regulations would muddy the water between the public benefit requirement as it applies to a charity's charitable purposes, and the activities of the charity in furthering those purposes.

64. Some respondents felt that charities established for the advancement of religion should not have to demonstrate their public benefit, several stating that public benefit was inherent in a religious charity.

Q14: Do you agree that the annual report of a charity is the best medium through which to report public benefit? If not, please explain what other medium should be considered and why.

65. 63 responses were received to this question. 79% either agreed or partly agreed that the Trustees' Annual Report is the best medium through which to report public benefit. 21% of respondents either disagreed or partly disagreed.

66. Most of those respondents who agreed considered that using the existing mechanism of the Trustees' Annual Report would minimise the regulatory burden on charities, and prove the most cost effective way of ensuring that the charity's activities and achievements were reported in the context of furthering the charity's purposes for the public benefit.

67. Whilst they could see the advantages of reporting through the Trustees' Annual Report, some respondents felt that charities could better report public benefit

through different means, such as the Summary Information Return, specific Impact reports on the charity's work, or on the charity's website.

68. Two respondents argued that charities should only have to make their public benefit clear once; at registration for new charities, and in a one-off report for existing charities. They considered that an annual reporting requirement was too burdensome for charities.

Q15: Do the draft 2007 Regulations achieve the right balance in reporting public benefit and the regulatory cost of providing such information? If not, how might the provisions be improved?

69. There was agreement amongst the majority of respondents, that any reporting requirement in the Regulations should not create a significant new burden for charities. A number of respondents were particularly concerned that small charities – often volunteer run, would not be in a position to take on new regulatory burdens.

70. Six respondents suggested that the Charity Commission should provide example annuals reports to help trustees understand what is required of them. The Commission already publishes examples of Trustees' Annual Reports, and has said that it will update these to reflect the changes in the regulations, including the requirement to set the reporting of the charity's activities in the context of furthering its purposes for the public benefit.

71. One respondent was concerned that auditors or independent examiners might be required to make judgements on a charity's public benefit as part of the audit or examination. This is not the case – the assessment of public benefit is for the Charity Commission, as independent regulator, and does not form part of the audit, examination or certification of a charity's accounts.

72. Two respondents argued for more detailed requirements for charities to report on their public benefit, including financial reporting on the value of public benefit provided by the charity set against the value of charitable tax reliefs that the charity receives. This was considered and rejected not least because there is no recognised basis for calculating and allocating a financial value to the public benefit of a charity. Any attempt to create such a basis would be disproportionately onerous for charities, and for many charities, public benefit is simply not financially quantifiable.

73. Several respondents made the link between the proposed reporting requirement in the draft Regulations, and the Charity Commission's guidance on public benefit. Many respondents argued that for the reporting requirement to work properly, there would need to be clear guidance on public benefit for charities, and particular guidance for some types of charities – such as religious charities – where the presumption of public benefit will be removed by the Charities Act 2006. One respondent argued that reporting requirements should not be considered at all until after the Commission's public benefit guidance was published. The Charity Commission published its guidance on public benefit in January 2008, has published more detailed guidance for religious and poverty charities in February 2008, and will shortly publish detailed guidance on education charities and charities that charge fees.

74. Several respondents commented on the requirement that charity trustees must confirm that they have had regard to the Charity Commission's public benefit

guidance. It was generally supported as a mechanism for ensuring trustees had read and considered the Commission's guidance. However, some respondents wondered whether it might simply become a "tick box exercise", and questioned the need for this type of compliance reporting.

The approach taken to reporting public benefit in the Regulations

75. Our approach seeks to ensure that Trustees' Annual Reports do focus the reporting of activities on furthering a charity's purposes for the public benefit, whilst seeking to minimise the burden on charities – particularly smaller charities.

76. Under the Charities Act 2006, to qualify as a charity an organisation must have wholly charitable purposes, and those purposes must be for the public benefit.

77. A charity's activities must further or support its charitable purposes for the public benefit. The existing Regulations require trustees to provide details of their charity's activities and achievements in the relevant year, in the context of furthering the charity's purposes. The new Regulations focus the context in which activities and achievements are reported on furthering the charity's purposes for the public benefit.

78. The charity sector is incredibly diverse, and describing public benefit provides particular challenges to charities where the benefits to the public may be less tangible or quantifiable, or where their work may not be popular with sections of the general public (for example working for asylum seekers' rights). We accept that a one-size fits all approach is not suitable.

79. Whilst the Regulations do not contain a requirement for charities to explain *how* their activities and achievements benefit the public, charities may choose to do so as a matter of best practice. We believe that it would be too onerous for charities to be expected to explain in detail how their activities are for the public benefit.

80. However, setting the reporting of activities in the context of furthering the charity's purposes for the public benefit encourages trustees to raise public awareness of their charity's public benefit by demonstrating that the charity's aims are being carried out for the public benefit. The reporting requirement in the Regulations builds on the existing requirements, but focuses the report so that the user can see how the charity's activities have furthered the purposes of the charity for the public benefit.

81. The requirement for the Trustees' Annual Report to set out the charity's activities in the context of furthering the charity's purposes for the public benefit is different to the public benefit requirement. As the Charity Commission has said in its guidance on public benefit: *"Failure to meet the public benefit requirement means that the organisation would not be charitable. Failure to meet the public benefit reporting requirement means that the charity trustees are failing in their statutory duty but it does not necessarily mean that the organisation is not a charity."*

Regulatory Impact Assessment

Q16: Do you have any comments about the partial Regulatory Impact Assessment (RIA) that accompanies this consultation? Does it present a sound analysis of the costs of compliance for charities and the benefits the Regulations will bring?

82. Eight respondents commented on this question. Six (75%) either agreed or partly agreed that the analysis of compliance costs and benefits was sound, whilst two disagreed. A number of respondents had specific comments.

83. Two respondents felt that training costs should be factored into the Impact Assessment, particularly in relation to group accounts and the independent examination of small charitable companies. However, whilst the introduction of preparation and scrutiny of group accounts is a new statutory requirement, it does reflect current sector practice. Nevertheless, the Impact Assessment has been adjusted to include a cost element for training and familiarisation for charities affected by the group accounts changes. The same respondents also considered that charity groups below the threshold would also be affected as they would need to ensure they were below the threshold. We do not consider this would add notably to existing compliance costs.

84. One respondent questioned whether parent charities below the group accounts threshold but with subsidiaries that took their group income over the threshold, had been recognised in the calculations. These had already been recognised by adjustments made in the partial Impact Assessment (paragraphs 10.1.3 and 10.1.4).

85. One respondent suggested that group accounts preparation costs had been underestimated, although without providing detail as to why. We revisited the costing of group accounts preparation and have increased the preparation costs uplift for group accounts in the final impact assessment from 25% to 34%. The higher uplift percentage represents the average increase of a parent charity's income from activities undertaken through subsidiaries.

86. Two respondents commented on the cost of auditing group accounts, suggesting that they were underestimated. One respondent was not sure whether the estimated average audit costs of £8,000 in the partial impact assessment included the audit costs associated with subsidiaries in order to reach an opinion on the group. The audit cost figure used in the partial impact assessment includes the audit costs relating to subsidiaries *where held*. In addition the Companies Act 1985 effectively required the audit of company charities where the group income exceeded £350,000 net (or £420,000 gross) of consolidation adjustments so the impact for charitable company headed groups is less than for non-company parent charities. For non-company charities it could be argued that in order to form an opinion on the group, additional audit work would be required on the subsidiaries that do not themselves have to be audited under statute. In the final impact assessment we have recognised this by applying a 34% uplift to the cost of auditing a non-company charity headed group. The 34% represents the typical increase to the parent charity's income from activities undertaken through subsidiaries.

87. Some respondents were concerned about the complexity of the Primary legislation, particularly as the Charities Act 1993 would be amended by both the Charities Act 2006 and the draft section 77 Order. We have recognised these concerns and published on our website an informal consolidation of Part 6 of, and Schedule 5A to, the Charities Act 1993 showing the changes made by the Charities Act 2006 and

the Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008.

Q17: Do you have any comments or suggestions on the drafting of the Regulations as they apply to general and special case charities?

88. A number of respondents had comments on the drafting of the regulations.

89. One respondent raised a concern about a potential loophole where several charities could work through non-charitable undertakings that are under the shared control of the charities (rather than each using their own subsidiary undertakings), as a means of avoiding audit. We think the likelihood of charities joining together in joint venture agreements to avoid audit is unlikely. We have however amended the Regulations to ensure that where activities are undertaken through joint ventures or interests are held in associates these are accounted for in line with accounting standards and generally accepted practice.

90. Two respondents raised the issue of the possibility of electronic submission of accounts, and a potential fraud risk arising from public display of accounts signed by the trustees. The Regulations provide for evidencing of trustees approval of accounts by way of signature. The filing of accounts requires a copy of such accounts to be forwarded to the Commission but creates no requirement for signed accounts to be displayed electronically. The Commission are giving consideration to its administrative practices in this area where charities have concerns about signatures being available in copy accounts displayed on its website.

91. Three respondents raised questions about the provisions relating to dispensations from audit or examination requirements. One respondent suggested that there should be a power for the Charity Commission to dispense with the requirement for independent examination in exceptional circumstances. Feedback from the Commission indicates that they cannot envisage a situation where they would wish to give a dispensation from independent examination. The costs of independent examination are much lower than audit and provide the minimum level of assurance consistent with maintaining public confidence.

92. Two respondents argued that the circumstances where the Charity Commission could grant a dispensation from audit should be extended to where the Comptroller and Auditor General, or the Auditor General for Wales, had undertaken an independent examination of the accounts of a charity – rather than an audit. We are not aware of circumstances where the Comptroller and Auditor General, or the Auditor General for Wales, would undertake an independent examination as opposed to an audit. We will explore these points with the National Audit Office and Wales Audit Office, and if it considered appropriate would consider making an Order under s.43(8) to add the Comptroller and Auditor General, or the Auditor General for Wales to the list of those professional bodies whose members are qualified to undertake an independent examination of charities with an income of over £250,000.

Other Changes made to the Regulations post-consultation

93. The Regulations have been restructured to make them easier to follow. Several respondents to the consultation offered comments on the structure and ordering of the Regulations. In particular the Regulations have been reordered and now follow a more logical sequence. In addition some Regulations are now set out in full rather than simply scheduling the substitutions made to particular Regulations.

94. Several minor drafting changes have been made to the regulations following consultation. Not all were made as a result of consultation responses, but we are very grateful to those respondents who suggested some of these minor drafting changes.

Regulations relating to Investment Fund Charities

95. A separate consultation was sent to the small number (fewer than 50) of Investment Fund Charities. This group of highly specialised charities comprises Common investment Funds ("CIFs") and Common Deposit Funds ("CDFs"). The proposed changes for Investment Fund Charities would update the relevant parts of the existing Regulations to maintain the consistency of reporting requirements with the Investment Management Association's Statement of Recommended Accounting Practice for the Financial Statements of Authorised Funds ("the IMA SORP") which was revised in December 2005.

96. The IMA SORP sets out recommended accounting practice for authorised unit trusts and open-ended investment companies in the UK. The 2005 Regulations drew heavily on the recommendations contained in the IMA SORP 2003 recognising that the information needs of charities participating in investment fund charities were very similar to those of general investors in commercial collective investment schemes such as unit trusts and open-ended investment companies.

97. Whilst the accounting changes introduced by the IMA SORP 2005 were not great, it is important that the accounting regime for Investment Fund charities reflects changes in terminology, presentation and the disclosure of gains and losses from derivative transactions introduced by the new SORP.

98. The new Regulations relating to the preparation and scrutiny of group accounts are unlikely to affect any investment fund charities currently registered as none operate through a group structure with subsidiary undertakings. Nevertheless, there is no legal prohibition on them acquiring or forming subsidiary undertakings and therefore it was considered prudent for the draft Regulations to set a framework for the preparation and scrutiny of such accounts and the related annual report.

99. The draft Regulations were circulated for consultation to all Investment Fund charities and other stakeholders with an interest in Investment Fund Charities. Only one response was received in relation to the changes relating to Investment Fund charities, which supported the draft Regulations for Investment Fund Charities. The respondent stated that it seems wholly sensible that the specific Regulations stated for charity investment funds are as prescriptive, and where possible, consistent with the IMA SORP as possible. The respondent went on to say that the Regulations present undoubted benefits and clarity, whilst the costs associated with them appear to be negligible. The respondent did raise a point about the applicability of VAT to management charges, although they recognised that this was beyond the scope of the consultation and the draft Regulations.

100. No significant changes have been made following consultation to the Regulations that affect Investment Fund charities, other than minor drafting changes, and the restructuring of the Regulations to make them easier for the user to follow.