EXPLANATORY MEMORANDUM TO

THE CHARITIES ACT 2011 (ACCOUNTS AND AUDIT) ORDER 2015

2015 No. 321

AND

THE CHARITIES ACT 2011 (GROUP ACCOUNTS) REGULATIONS 2015

2015 No. 322

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

2. Purpose of the instrument

2.1 These instruments increase various financial thresholds under the Charities Act 2011 and the Order adds two new bodies to the list of bodies whose members may examine accounts of certain lower-income charities.

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

3.1 None

4. Legislative Context

The Charities Act 2011 (Accounts and Audit) Order 2015

4.1 Section 144 of the Charities Act 2011 specifies the gross income and asset thresholds above which most charities must have their annual accounts audited by an appropriately qualified professional. These thresholds reflect the fact that the form of external scrutiny of charity accounts should be proportionate to the size of the charity. If a charity falls below these thresholds but above those in section 145, it must have its accounts independently examined by a member of one of the recognised professional accountancy bodies also detailed in section 145 instead.

The Charities Act 2011 (Group Accounts) Regulations 2015

4.3 Sections 138 and 139 of the Charities Act 2011 provide that a parent company must prepare group accounts if the aggregate total income of the group exceeds a

threshold specified in regulations made by the Minister. Sections 151 and 176 require prepared group accounts to be audited if the aggregate total income of the group exceeds a separate threshold, also prescribed by regulations made by the Minister.

5. Territorial Extent and Application

5.1 These instruments apply to England and Wales.

6. European Convention on Human Rights

6.1 The Minister for Civil Society, Rob Wilson, has made the following statement regarding Human Rights:

In my view the provisions of the Charities Act 2011 (Accounts and Audit) Order 2015 and the Charities Act 2011 (Group Accounts) Regulations 2015 are compatible with the Convention rights.

7. Policy background

7.1 Accurate, clear and publicly available information about charities' finances and activities is essential to ensure public confidence in both individual charities and the charity sector as a whole. Charity law requires charities to be transparent and accountable but it is important that that the regulatory requirements are proportionate. It is also important that, where it is a legal requirement, the independent external scrutiny of charities' accounts is carried out by people who are suitably qualified to carry out an examination in a way that is proportionate to the size of the charity.

7.2 The requirements for the independent scrutiny of charity accounts become increasingly demanding the larger a charity is until there is a requirement for annual accounts to be audited by an auditor whose name appears on the Register of Statutory Auditors, if a charity has:

- an annual income from all sources (income) of more than £500,000 ("the income threshold"); or
- assets worth more than £3.26 million and an income of more than £250,000 (together, "the asset threshold").

Charities with an income below those thresholds can have their accounts audited, either because their governing document requires it, or voluntarily at the instigation of trustees or funders.

7.3 In his report on the operation of the Charities Act 2006, *Trusted and Independent: Giving charity back to charities*, Lord Hodgson of Astley Abbotts recommended that charities should only have their accounts compulsorily audited if their income is more than £1 million, with no asset threshold.

In its response to Lord Hodgson, the Government partially accepted this recommendation and agreed, subject to consultation, to increase the income threshold but to retain an increased asset threshold.

7.4 The Government then consulted on increasing the thresholds so that a charity is required to have its accounts audited, or a parent charity has to have its group accounts audited, where it has:

- an annual income from all sources (income) of more than £1 million; or
- assets worth more than £3.26 million and an income of more than £500,000

The Government also sought views on whether there are any additional professional accountancy membership bodies that can be added to the list of those whose appropriately qualified members can carry out independent examinations of the accounts of charities with an income that is more than £250,000.

7.5 In the case of charities that have subsidiaries (charity group), the Government consulted simultaneously on increasing the threshold above which parent charities must prepare group accounts from a total income of £500,000 to £1 million. The Government also asked if the threshold above which group accounts must be audited should be consequentially increased from an aggregate group income of £500,000 to £1 million. The asset threshold does not apply to group accounts.

8. Consultation outcome

8.1 A full public consultation was carried out on a range of possible changes to the financial thresholds in the Charities Act 2011. The consultation ran from 9 December 2014 to 27 January 2015.

8.2 There were 56 responses to the consultation from a range of stakeholders. The consultation responses were largely supportive and the significant majority appreciated the effect the proposals would have in decreasing the regulatory burden on charities, offering either full or qualified support.

8.3 In particular, there was overwhelming support for increasing the income threshold above which charities must have their accounts audited from £500,000 to £1 million.

Respondents acknowledged that independent examination was a more proportionate form of scrutiny for charities of this size.

8.4 The Charities Act 2011 (Accounts and Audit) Order 2015 gives effect to the following changes:

8.4.1 The income threshold above which charities must have their accounts audited increases from £500,000 to £1 million.

8.4.2 The Institute of Financial Accountants and the Chartered Public Accountants Association are added to the list of recognised professional accountancy membership bodies whose appropriately qualified members can carry out independent examinations of the accounts of charities with incomes that are more than £250,000.

8.5 The Charities Act 2011 (Group Accounts) Regulations 2015 gives effect to the following changes:

8.5.1 The aggregate group income threshold at which parent charities should have group accounts audited increases from £500,000 to £1 million.

8.5.2 The preparation threshold for group accounts increases from £500,000 to £1 million.

8.6 Both statutory instruments will apply to any financial year of a charity ending on or after 31 March 2015. Please note that the instruments only come into force on this date and are not retrospective.

8.7 One change proposed in the consultation document is not being taken forward at this time:

8.7.1 The consultation proposed increasing the income component of the asset threshold from £250,000 to £500,000. This is the annual income above which total value of assets is considered in determining whether a charity must have its accounts audited. This particular change is not being taken forward because the link between this threshold and the threshold for the preparation of accruals accounts is on the face of the Charities Act 2011 and primary legislation would be required to unlink them (it is not proposed to increase the accruals accounts preparation threshold).

8.8 A full analysis of the consultation responses is available on gov.uk:

https://www.gov.uk/government/consultations/charities-audit-and-independent-examination

9. Guidance

9.1 The Office for Civil Society will work with the Charity Commission to publicise these changes prior to commencement, with an explanation of the practical impact of the new thresholds for charities.

9.2 The Charity Commission website (charitycommission.gov.uk) provides detailed guidance on reporting and accounting requirements for charities, which is being updated to reflect the changes to the relevant financial thresholds.

10. Impact

10.1 An Impact Assessment applying to both statutory instruments is attached to this memorandum. This estimated the savings to charities of increasing both the income threshold and the asset threshold, as proposed in the initial consultation document. 3,800 charities were expected to benefit from these changes and the total estimated savings to charities were calculated at £5.61 million per year.

10.2 Although the Government is no longer making changes to the asset threshold, the significant majority of savings accrue from increasing the income threshold and so savings to charities will not be far from the above figure. 3,140 charities of the 3,800 estimated by the Impact Assessment will benefit.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Government will review the operation of these changes within three years of their commencement.

12.2 Additionally, requests continue to be welcomed by the Cabinet Office to add to the list of recognised professional accountancy membership bodies whose appropriately qualified members can carry out independent examinations of the accounts of charities with incomes that are more than £250,000.

13. Contact

13.1 Ben Harrison at the Office for Civil Society, Cabinet Office (tel: 020 7271 6282 or email: ben.harrison@cabinetoffice.gov.uk) can answer any queries regarding the instrument.