EXPLANATORY MEMORANDUM TO

THE CHARITIES ACT 2006 (CHARITABLE COMPANIES AUDIT AND GROUP ACCOUNTS PROVISIONS) ORDER 2008

2008 No.

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 This Order amends the Charities Act 1993 (the 1993 Act) to:

2.1.1 enable the scrutiny, as a matter of charity law, of the accounts of charities that are companies ("charitable companies") that are not required to be scrutinised as a matter of company law; and

2.1.2 extend the requirement to prepare group accounts under that Act to charitable companies that are not required to produce group accounts under company law.

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 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 Charities (Accounts and Reports) Regulations 2005 currently set out the form that those accounts are required to take and methods and principles to be followed in their preparation, as well as detailed requirements for the scrutiny of those accounts.

4.2 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.

4.3 Neither Part 6 of nor Schedule 5A to the 1993 Act currently applies to charitable companies.

4.4 During the passage of the Companies Bill (now the Companies Act 2006) amendments were tabled to the Bill that would have had the effect of removing small charitable companies from the company law regime for accounts scrutiny

and instead placed them within the charity law regime[1]. The Government accepted that there was merit in small charitable companies, in so far as their accounts scrutiny was concerned, complying with the requirements of charity rather than company law. The Office of the Third Sector also sought the views of sector umbrella bodies who welcomed the idea.

4.5 The necessary amendments were made in the Companies Bill (now the Companies Act 2006) to achieve this. The relevant provisions can now be found in section 1175 of and Schedule 9 to the Companies Act 2006.[2] These provisions are due to be commenced on 1st April 2008.

4.6 It was decided that an enabling power, provided in section 77 of the Charities Act 2006, would deal with the appropriate changes required to be made to charity law following the removal of small charitable companies from the company law accounts scrutiny regime.[3] This Order is made in exercise of that power and is the first exercise of it.

4.7 Changes will also be required to the Charities (Accounts and Reports) Regulations 2005 as a consequence of the changes made by this Order and the new requirement to prepare group accounts in Schedule 5A to the 1993 Act. The Office of the Third Sector has carried out a consultation on the proposed amendments, which is available on the website of the Office of the Third Sector[4], and the content of those Regulations is being finalised following the consultation. It is expected that the Regulations will be made following the commencement of articles 1 and 3 of this Order.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

6.1 Phil Hope MP, Parliamentary Secretary, Cabinet Office, has made the following statement regarding Human Rights:

"In my view the provisions of the Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 are compatible with the Convention rights."

[1] Lords Hansard, 7 Mar 2006 : Column GC280
[2] Companies Bill, Commons Report Stage, 17-19 October 2006. A copy of the Act is available on the website of the Office of Public Sector Information: http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en_1.
[3] Charities Bill, Commons Report Stage, 25 October 2006, Hansard Col 1539
[4] www.cabinetoffice.gov.uk/third_sector/Consultations/completed_consultations/audit_accounting_reporting.aspx

7. Policy background

7.1 Currently, the accounts scrutiny provisions of Part 6 of and Schedule 5A to the 1993 Act have no application to charities that are companies.

7.2 This Order will apply the accounts scrutiny provisions of Part 6 to the individual accounts of those charities that are companies, where those accounts do not have to be audited under company law. This is linked to changes to company law which will have the effect of removing the special accounts scrutiny provisions currently applying to small charitable companies (section 1175 of, and schedule 9 to, the Companies Act 2006). Without these changes being made to the 1993 Act, the amendments to company law would have had the effect of creating an accounts scrutiny threshold for charitable companies which are much higher than that applying to charities constituted in other ways.

7.3 This Order will also extend the scope of the new provisions in Schedule 5A to the 1993 Act relating to the preparation and scrutiny of group accounts by parent charities to those parent charities which are companies but which do not, under company law, have any obligation to prepare group accounts.

7.4 These provisions of the draft order are designed to create a "level playing field" in terms of external scrutiny arrangements for charity accounts and for the preparation of group accounts.

7.5 The Office of the Third Sector undertook a 13 week public consultation on the draft Order, and the 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.

7.6 86 responses were received to the consultation. Most respondents' comments related to the draft Charities (Accounts and Reports) Regulations, which are not covered here. 15 respondents commented on the draft Order, with the majority positively welcoming the policy objective of creating a level playing field for the external scrutiny of charity accounts. One respondent recommended a de-regulatory change to the independent examination threshold, which will be considered as part of a separate consultation being run jointly be the Office of the Third Sector and Charity Commission on proposed changes to various financial thresholds in the Charities Acts.[5] Two respondents commented on the complexity of the legislation, given the changes being made to the Charities Act 1993 by both the Charities Act 2006 and the Order. The Office of the Third Sector accepts this point, and aims to prepare a consolidated version of Part 6 of the Charities Act 1993 to show the effect of these changes prior to commencement.

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5 http://www.cabinetoffice.gov.uk/third_sector/Consultations/current_consultations/financial_thresholds_charities_act.aspx

7.7 These changes 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.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

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 Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008	
Stage: Final / Implementation	**Version:** 2.01	**Date:** 7 January 2008

Related Publications:

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

Explanatory Memorandum to the Order

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

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?

During the passage of the Companies Act 2006 through Parliament there was debate on the scrutiny arrangements for charities below the professional audit threshold(s). It was argued that:

- having different régimes for smaller charities that are companies and smaller unincorporated charities – régimes which are similar in their aims but different in detail – is unnecessarily complex and confusing;
- the independent examination régime is more appropriate for charities than the reporting accountant régime because it is a form of scrutiny designed specifically for charities (as opposed to small businesses).

These were arguments for treating smaller charities that are companies as charities rather than companies for the purpose of audit or examination of accounts. The Office of the Third Sector sought the views of sector umbrella bodies and professional accountancy bodies who welcomed the idea and the Government accepted its merit. Parliament agreed that the audit/examination arrangements for the accounts of small charities that are companies, which are currently set out in the Companies Act 1985, would be taken out of company law and instead dealt with under charity law. The necessary amendments were made to company law by means of the Companies Act 2006 (see section 1175 and Schedule 9). However, it was decided that an enabling power, set out in section 77 of the Charities Act 2006, should be provided in order to deal with the appropriate changes to charity law. The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 will make those changes.

The Order also makes provision for the preparation and audit of group accounts by company charities that are not required to prepare group accounts under company law. The requirement to prepare group accounts under charity law will be subject to a threshold that will apply to company and non-company charities alike, which will be specified in separate regulations - The Charities (Accounts and Reports) Regulations 2008).

What are the policy objectives and the intended effects?

Applying charity law audit and independent examination arrangements to small charitable companies will simplify the audit and examination requirements for charities and create a level playing field for the audit or examination of charities whether set up as companies or as unincorporated bodies.

The Order will also extend the application of the new group accounting provisions of the Charities Act 2006 to those parent charities which are companies but which are not required by company law to prepare group accounts. These provisions are expected to take effect from 1 April 2008.

New Regulations are required to provide reporting duties for auditors undertaking the audit of group accounts under the Charities Act 1993. 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). These regulations are covered in a separate Impact Assessment.

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

Option 1: Do not implement the Order, and Companies Act provisions not commenced

If the Order were not implemented, and the relevant provisions of the Companies Act 2006 (s.1175 and Schedule 9) were not commenced, there would be no change to the current position, with small company charities continuing to follow the company law audit or examination requirements. This would not deliver the long called-for level playing field for the scrutiny of small company and non-company charities' accounts. It would also result in different preparation and scrutiny requirements being applied to the group accounts of groups headed by company and non company charities.

Option 2: Do not implement the Order, and Companies Act provisions commenced

This option would mean that there would be no requirement for independent scrutiny of small company charities' accounts. It would create far wider disparities between the scrutiny of small company and non company charities' accounts, and the accounts of groups headed by a company or non company charity.

Option 3: Implement the proposed Order

Implementing the Order will enable the relevant provisions of the Companies Act 2006 to be commenced. It will ensure that at the same time that small company charities are taken out of the company law scrutiny regime, the charity law scrutiny regime is applied to them, and the level playing field for the scrutiny of small company and non-company charities' accounts is created. It will also extend the requirement for charity groups to prepare group accounts to groups headed by company charities that are not required to prepare group accounts by virtue of company law. This is the preferred option.

The reporting duties proposed are consistent with those previously applied under the Companies Act 1985. The audits carried out will continue to follow the same auditing standards and charity audit guidance issued by the Auditing Practices Board. The proposed change to allow an audit to be undertaken under the Charities Act 1993 is therefore considered to be cost neutral.

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

The impact of the Order will be monitored on an ongoing basis by the Charity Commission and the Office of the Third Sector. The Charities Act 2006 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: Phil Hope ..... Date: 20 January 2008

Summary: Analysis & Evidence

Policy Option: 3	Description: Implementing the Charities Act 2006 (Charitable Companies Audit and Group Accounts) Provisions Order 2008

COSTS

ANNUAL COSTS	
One-off (Transition) **Yrs**	Description and scale of **key monetised costs** by 'main affected groups' 6,234 company charities with an income between £10,000 and £90,000 will be required to have their accounts independently examined, costing an average of £213 per year. They are not currently required to undergo any external accounts scrutiny. However evidence suggests that 85% of charities in this group choose to have their accounts independently scrutinised.
£	
Average Annual Cost (excluding one-off)	
£ 213	**Total Cost** (PV) **£ 199,155**

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

Applying the requirement to prepare group accounts to company charities that head groups is not expected to result in any additional costs, as there is evidence that indicates that 99% of charities that head groups already prepare group accounts on a non-statutory basis.

BENEFITS

ANNUAL BENEFITS	
One-off **Yrs**	Description and scale of **key monetised benefits** by 'main affected groups' 7,866 company charities with an income between £90,000 and £500,000 will be able to opt to have independent examination of their accounts, which is slightly cheaper than an audit exemption report (which is the current requirement).
£	
Average Annual Benefit (excluding one-off)	
£ 37	**Total Benefit** (PV) **£ 291,042**

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

A simpler and clearer single regime for the external scrutiny of the accounts of both company and non-company charities with an annual income below £500,000.

Key Assumptions/Sensitivities/Risks

Assumption that under business as usual (BAU) that 85% of company charities with an income between £10k and £90k choose to have their accounts independently examined or audited (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 - £10k N/A	£10k - £90k £213	£90k-£250k £-37	£250k-£500k £-37
Are any of these organisations exempt?	Yes	No	No	No

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

Increase of £ 199,155 Decrease of £ 291,042 **Net Impact** **-£91,887**

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

Evidence Base (for summary sheets)

External scrutiny of small company charities' accounts

1. The Order will bring small company charities into the scrutiny regime of Part 6 of the Charities Act 1993 (i.e. those charitable companies which are not required to have their individual accounts audited under company law).

2. This will simplify the external scrutiny arrangements for company and non-company charities by providing a common framework. It will address a long standing sector concern as to 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.

3. The extension of the accounts scrutiny regime in Part 6 of the 1993 Act to the individual accounts of small charitable companies creates a need for new accounting and reporting Regulations to address the reporting duties of auditors and independent examiners of small company charities. Draft Regulations underwent public consultation in 2007 and will be taken forward once this Order has been made.

4. The reporting duties of an independent examiner are somewhat different to the duties placed on a reporting accountant by the Companies Act 1985 although data from the Administrative Burdens Reduction Project indicate that costs are similar. The indicative external cost of £250 for an accountant's report exceeds the £213 external cost estimated for an independent examination. It is also anticipated that the implementation of the change to independent examination will permit small company charities to realise the saving from a more uniformed scrutiny regime and a larger pool of potential examiners, with the competitive saving more than offsetting any additional work involved.

5. Many charities opt to have a form of external scrutiny, even when there is no mandatory requirement, and consequently it is assumed that a business as usual (BAU) adjustment would apply to the extension of independent examination to small company charities which previously have had the more expensive audit exemption report on a voluntary or mandatory basis.

6. Currently, company charities with an income between £10,000 and £90,000 are not required by law to have their accounts independently scrutinised. However, a sampling exercise of filed accounts undertaken by the Charity Commission found that 85% of company charities within this income bracket nevertheless did choose to undertake a form of independent accounts scrutiny. This would support the argument for including a business as usual (BAU) adjustment. It has therefore been assumed that 85% of small company charities that are not currently required by law to have their accounts scrutinised, would in any event seek independent scrutiny of their accounts.

7. The external scrutiny arrangements of the 1993 Act also apply to excepted charities. However, very few excepted charities are constituted as companies and therefore the impact of the proposed Regulations on this part of the sector is likely to be minimal.

8. If these cost estimates (see above) are applied to those charities affected, the following costs and savings are derived:

Income band	Number of Charities in company form	Number of Charities (taking 85% BAU into account)	Cost / saving per charity £	Introduction of independent examination costs £	New regime savings £	Total costs £ -
£10,000 to £90,000	6,234	935	£ 213	£ 199,155	-	£ 199,155
£90,000 to £250,000	4,879	N/A	£ (37)	-	£ (180,523)	£ (180,523)
£250,000 to £500,000	2,987	N/A	£ (37)	-	£ (110,519)	£ (110,519)
Total	14,100	-	-	£ 199,155	£ (291,042)	**£ (91,887)**

The preparation and scrutiny of group accounts

9. Whilst there is currently no mandatory legal requirement for the preparation and scrutiny of group accounts, the Charities SORP recommends the preparation and audit of group accounts by charities above the audit threshold, where to do so would present a true and fair view of the group.
10. The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) Order 2008 will extend the group accounts provisions of the Charities Act 2006 to apply to groups headed by company charities that are not required to prepare group accounts under company law, resulting in a single set of requirements for the preparation and scrutiny of group accounts of both non-company charity and company charity headed groups.
11. The Charity Commission looked at a sample of 70 sets of accounts where group accounts would be expected to be produced as a matter of good practice. In all but one of the cases group accounts were prepared, and in the only case where group accounts were not prepared, this was on the basis that the inclusion of the subsidiary would not be material for the purpose of a true and fair view. This analysis suggests that the practice of preparing group accounts (albeit on a non-statutory basis) is already being undertaken by 99% of charity headed groups. Therefore, on the basis of business as usual (BAU) costs, no additional costs are expected

Consultation

12. In 2007 the Office of the Third Sector undertook a 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 our 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 Commission's public benefit consultation.

13. In all, 86 responses were received. Many of those limited themselves to comments on the changes to the regulations. 15 of the respondents commented on the proposals in the draft order. None opposed the policy objective of unifying the accounts scrutiny requirements for small non-company and company charities. The responses relating to the draft regulations are covered in a separate Impact Assessment relating to the draft regulations.

14. 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. As discussed in paragraph 6 above, 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.

15. 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.[1]

16. 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 accepts this point, and aims to prepare a consolidated version of Part 6 of the Charities Act for publication on its website prior to commencement of the provisions.

[1] www.cabinetoffice.gov.uk/third_sector/Consultations/current_consultations/financial_thresholds_charities_act.aspx

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