



## Financial management

### Section ten Annual accounts

(adapted from the Resource Centre's information sheet, *Charity Reports and Accounts*)

This section is written assuming that most RCOs will have charitable aims. Even if you are not a registered charity, your organisation might want to consider adopting the procedures outlined below as good practice.

Please also be aware that accounting rules are constantly changing, so it is important that the people responsible for your accounts update their knowledge on a regular basis. You should get professional advice from a community accountant if you are unsure about any of the rules. [See [www.communityaccounting.org](http://www.communityaccounting.org) to find a community accountancy service in your region]

#### 10.1 What is the aim of preparing annual accounts, reports and returns?

By law, every charity must prepare a set of accounts. Most registered charities must prepare a trustees' annual report, a set of accounts, and an annual return. The aim of accounts and reports is to provide a clear picture of your charity's activities and financial position.

Although these requirements might initially seem difficult for a small charity, they do require you to define your aims and activities clearly and to manage your finances well, both of which will help to make your organisation more effective. The trustees' report is also an opportunity to describe your work to the public and to funding bodies.

#### 10.2 Accounts, reports and returns – what do you have to do?

- Every charity, even if it is not required to register with the Charity Commission, must keep accounting records. These include cash books, receipts, records of grants, and they must be retained for six years.
- Every charity must prepare annual accounts and make them available on request. Every charity with an annual income **above £5,000** is required by

law to register with the Charity Commission and to produce a trustees' annual report. (There are a few exceptions to this rule).

- Every registered charity with annual income or expenditure **above £10,000** must submit a trustees' annual report, set of accounts, and an annual return to the Charity Commission each year. These must be sent or filed online within ten months of the end of the financial year. If you are a charitable company you must file your accounts at Companies House within nine months.
- Your constitution or other governing document will usually require you to send the annual accounts (where appropriate) to members and approve them at an annual general meeting (AGM). It is certainly good practice to do so even if you are not required to.
- The type of accounts and report which your charity has to prepare depends on your legal structure, your income and the value of your assets.

### 10.3 Legal structures

Charities can be divided into two basic categories:

- a) Charities which are unincorporated associations (referred to as unincorporated charities) and
- b) Charities which are incorporated
  - i. Limited companies (referred to as charitable companies)
  - ii. Charitable Incorporated Organisations (CIO)

[See the **governance toolkit** for more information about legal structures.]

### 10.4 Who needs to prepare accounts?

- An unincorporated charity with a gross income of **£10,000 or less** during the financial year may prepare accounts on either the receipts and payments basis or the accruals basis [as described in **Section two**].
- At present every charitable company must also prepare accruals accounts. However the Charities Act 2006 and Companies Act 2006 are introducing a number of changes. Charitable companies which qualify as small companies under company law will be subject to charity law provisions – they will come under the same accounting regulations as unincorporated charities above. This change is expected to affect charitable companies during 2008.
- Some time in 2008 a new form of charity – the Charitable Incorporated Organisations (CIO) – will come into existence. This too will have to follow the same accounting regulations as unincorporated charities above.

**[Please note:** Gross income is defined by the Charity Commission as your total recorded income excluding loans, proceeds from the sale of assets and certain other 'specialist' types of income.]

## 10.5 Receipts and payments accounts

This is a simplified form of accounting which summarises the money your charity has received and paid out during the financial year [see **Section two**]. The final balance shows how much money your charity has at the end of the year.

You do not have to prepare receipts and payments in any particular format but they should be prepared in a consistent way from year to year (see the Charity Commission website for templates to assist you).

If you present receipts and payments accounts, you must also provide a statement listing assets and liabilities at the end of the year. This shows debtors (that is, money owed to the charity), creditors (that is, money which the charity owes) and the value of equipment, land and buildings.

When the financial structure of the charity becomes more complicated, it may be better to adopt accruals-based accounting. You may need to get professional advice if you move over to accruals accounting in order to ensure that you make the change smoothly, and keep the right sort of records during the year to enable your charity to complete the annual accounts required.

## 10.6 Accruals accounts (referred to as 'income and expenditure')

Accruals accounts present a clearer picture of the charity's income and expenditure during the year [see **Section two**]. They show income and expenditure as these relate to the year in question, rather than simply recording money received and paid out. The balance sheet gives a 'snapshot' of the charity's financial position at the end of the year.

A charity preparing accruals accounts must follow the Statement of Recommended Practice (Charity SORP). The report and accounts must consist of a balance sheet, a statement of financial activities (SOFA) showing incoming resources, how they were used, and explanatory notes.

The Charity Commission provides packs to help an unincorporated charity prepare accruals accounts and meet SORP requirements.

**[Please note:** All charities that prepare accruals accounts must follow the SORP. Smaller charities preparing receipts and payments accounts should follow the Charity Commission's guidance (see CC16/CC17 on the Charity Commission website). Although SORP is relevant to smaller charities, they do not have to follow all the recommendations in the same way.]

## 10.7 Checking (referred to as scrutiny of) accounts

There are two types of external account checking:

1. Independent examination
2. Audit

## 10.7.1 Independent examination and accounts

### What is independent examination?

- This is the process of checking (scrutinising) a charity's accounts below the level of a professional audit. The procedures are defined by law and by the Directions of the Charity Commission.
- The independent examiner will develop an understanding of the charity, look at the accounts and supporting documents and write an independent report to accompany the accounts and trustees' report.

### What is the role of an independent examiner?

- The role of the independent examiner is to give what is called 'negative assurance'. After looking at the evidence the examiner reports whether or not certain matters "have come to my attention". These include lack of accounting records and the failure of accounts to comply with the Charities Act.
- As well as checking the accounts, the independent examiner may also help prepare the accounts in the format required and help prepare the trustees' annual report.

### Who can be your independent examiner?

- An independent examiner could be your treasurer or finance worker or an accountant from industry or the public sector. The key is that they must have a good understanding of charity finance and the law.
- To carry out an independent examination of a charity with an income above £250,000 the examiner must have a professional qualification or be a Fellow of the Association of Charity Independent Examiners (ACIE).

### How should you choose your independent examiner?

- When choosing an independent examiner, you should make sure that he or she is fully independent of your charity and able to carry out a proper charity independent examination.
- The Charity Commission gives guidance on its website and in its publications on selecting an examiner. ACIE can give you the details of local examiners who are on its register. However, you do not have to register with the ACIE as there are many unregistered examiners who fully meet Charity Commission standards.

## 10.7.2 Audit

The audit process is defined by law and is carried out by a registered auditor (a chartered accountant). An audit is the highest level of account checking and the

auditor looks for positive evidence to enable the accounts to be described as a 'true and fair' view.

All charitable companies must have their accounts checked by a registered auditor, though smaller companies may only require an 'accounting report' rather than a full audit. Every charity with an annual income above £500,000 is required to have an audit.

Funders may ask for a copy of your audited accounts. If your charity is not required to have an audit, point this out and explain the legal basis of the independent examination or the accounting report (as appropriate) – the term 'audit' is often used very loosely.

### 10.7.3 What type of checking is required?

The type of checking required depends on whether the charity is a company and its income.

#### A. Unincorporated charities

- *Unincorporated charities with an income below £10,000* in the relevant financial year is not required to have its accounts externally checked, unless its constitution specifies an independent examination or audit. However it is good practice to have your accounts prepared or examined by someone independent.
- *An unincorporated charity with gross income above £10,000 but not exceeding £100,000* in the relevant financial year must have its accounts externally checked. Management committee members may choose either an independent examination or an audit, unless its constitution is specific.
- *An unincorporated charity with gross income above £100,000 but not exceeding £500,000* in the relevant financial year and total assets not exceeding £2.8m must have its accounts externally checked. Committee members may choose either an independent examination or an audit, unless its constitution is specific. If the charity chooses an independent examination and its gross income exceeds £250,000, the examiner must be a member of a body specified by the Charities Act 2006.
- *An unincorporated charity with a gross income above £500,000* in the relevant financial year or one whose gross assets exceed £2.8m and gross income exceeds £100,000 must have an audit.

#### B. Charitable companies and Charitable Incorporated Organisations

- A charitable company with either a *gross income above £500,000 or gross assets above £2.8m* must have its accounts audited by a registered auditor.
- A charitable company with *gross assets not exceeding £2.8m and income above £90,000 but below £500,000* may currently have an accountant's report (or audit exemption report) rather than a full audit.

- A charitable company with *gross income not exceeding £90,000 and assets not exceeding £2.8m* does not at present require any external checking (scrutiny). However, it must prepare a director's report and accounts under the Companies Act, and submit these to Companies House. Even a very small company is advised to use the services of a chartered accountant.
- In future, a charitable company with a *gross income below £500,000 and gross assets below £2.8m* will have to follow the same auditing procedures as unincorporated charities above. This change is expected to affect charitable companies sometime during 2008.

Note:

- A Charitable Incorporated Organisation will be expected to follow the same rules as an unincorporated charity.
- Charitable companies must send accounts to Companies House within **nine months** of the end of their financial year.

#### 10.7.4 Trustees' annual reports

Every charity with a gross income above £5,000 must prepare a trustees' annual report. The report should explain the aims of the charity and how it is achieving them. It is a chance to show the benefit to the public of the charity's work and also show funders how their money was used and what was achieved with it.

From the financial year 2008-09 every charity will be required to demonstrate that its activities are for the public benefit, [see **governance toolkit**] as set out in Charity Commission guidance. Every charity with a gross income above £10,000 must submit its trustees' annual report to the Charity Commission.

There are legal requirements for the contents of the report and these depend on the type of charity and its income. There is a useful list of headings which meet these legal requirements in the Charity Commission publication CC15 (see Charity Commission website). The headings cover reports from a simplified report to a full report. A simplified report must give basic details such as the names of trustees, the structure of the charity and a brief financial review as well as details of its aims and activities.

#### Who should prepare a trustees' annual report?

- A charity with a *gross income of £10,000 or less* must prepare a simplified annual report. A charity of this size should not send its annual report and accounts to the Charity Commission unless the Commission asks for them.
- A charity with a *gross income of over £10,000 but not exceeding £500,00 and with total assets not exceeding £2.8m* must prepare an annual report but it may be simplified. However charities are expected to provide 'full disclosure', so you should aim to give the maximum amount of detail appropriate to the size of your charity.

- A charity with a *gross income above £500,000 or whose gross assets exceed £2.8m and gross income exceeds £100,000* must complete a full annual report.

Note:

- Charities are not limited by the Statement of Recommended Practice (SORP) and may also include other matters such as an environmental impact report or a chair's report.
- The annual report and accounts must be sent to the Charity Commission or filed online within ten months of the end of the financial year. It is an offence not to submit the trustees' annual report and trustees can be fined.
- A charitable company must also prepare a **directors' report** under Companies Act. In practice, this report is usually expanded to include all the information required in the trustees' annual report. A charitable company must file its accounts at Companies House within nine months of the end of its financial year.

### 10.7.5 Annual return

The Charity Commission will send an annual return to every charity with a gross income of over £10,000. This asks you to update details such as:

- Name of trustees
- Bank account and charity classification and activities

You are also asked to confirm that there have been no serious incidents, for example, fraud or lack of policy to protect vulnerable people (where appropriate). You must return this by the deadline written on the annual return. It is an offence not to submit it.

### Who does not have to complete an annual return?

A charity with a gross income of up to £10,000 does not have to complete an annual return. The Charity Commission will send this category of charity an *annual information update form* which it should complete in order to keep its entry on the Charity Register up to date.

### 10.7.6 Registered status to appear on documents

A registered charity with a gross income of £10,000 or more in the last financial year is required by law to state on a range of documents that it is a registered charity and to quote its registration number. These documents include:

- Cheques
- Headed notepaper
- Advertisements
- Material placed on websites
- Any documents used for fundraising or membership purposes

## More information

- You can find out more about accounting requirements on the Charity Commission website on their Charity Accounts Page, Help with preparing Charity Accounts and Reports at **[www.charitycommission.gov.uk/investigations/sorp/default.asp](http://www.charitycommission.gov.uk/investigations/sorp/default.asp)**
- If your organisation needs advice on completing its annual return or annual update form – you can call Charity Commission Direct on 0845 300 0218

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