CENTRE FOR VOLUNTARY SECTOR RESEARCH

The Use of Receipts and Payments Accounts for Financial Reporting by Smaller Charities

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However, all views and opinions reported here, unless otherwise attributed, are those of the author.

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Abbreviations and short terms used

1992 Act	The Charities Act 1992 – *applicable to charities in E&W (note: the accounting provisions of the 1992 Act were subsequently consolidated in the 1993 Act)*
1993 Act	The Charities Act 1993 – *applicable to charities in E&W (all references are to the Act as amended from time to time, including amendments by the 2006 Act where relevant)*
2005 Act	The Charities and Trustees Investment (Scotland) Act 2005
2006 Act	The Charities Act 2006 – *applicable to charities in E&W*
Accruals basis	Accounts where the figures show accrued income (the income earned by the charity over the period) and accrued expenditure (the costs incurred by the charity) – *as opposed to R&P accounts*
ACIE	Association of Charity Independent Examiners
ACF	Association of Charitable Foundations
CC	Charity Commission (for England and Wales) – *formerly the Charity Commissioners*
CIO	Charitable Incorporated Organisation *(a new legal form for charities, established by the 2006 Act but not yet implemented at the time of this study; a similar form – the Scottish CIO or SCIO – will apply in Scotland)*
E&W	England and Wales
GAAP	General Accepted Accounting Practice
IE	Independent examiner
IFRS	International Financial Reporting Standards
FRS	Financial Reporting Standard
OSCR	Office of the Scottish Charity Regulator
R&P account	Receipts and payments account – *one of the two financial statements (the other one being the SOAL) in a set of charity accounts prepared on the R&P basis*
R&P basis	Accounts prepared on the receipts and payments basis *(recording simply money received and paid out)*
SHU	Sheffield Hallam University
SOAL	Statement of Assets and Liabilities *(a key statement required in charity accounts prepared on the R&P basis – replacing the need for a balance sheet)*
SOFA	Statement of financial activities *(a key statement required in charity accounts prepared on the accruals basis in SORP format)*
SORP	Statement of Recommended Practice on Accounting and Reporting by Charities.
SSAP	Statement of Standard Accounting Practice *(the precursor to FRSs)*

Foreword

By Fiona Gordon, Director of the Association of Charity Independent Examiners

The estimate in this study is that 80% of UK charities are entitled to prepare their annual accounts in a receipts and payments form. Whilst these charities may be individually small and their aggregated income is not huge, numerically they are obviously significant and this significance is replicated in the extent of the reach that they have into the lives of individuals and communities.

We at the Association of Charity Independent Examiners (ACIE) specialise in the scrutiny (and the preceding preparation) of the accounts of small UK charities. We know the importance of this body of charities. We also know how important it is that they account properly for the money with which they have been entrusted by members of the public or public bodies. The receipts and payments form provides them with a format with which many of them feel comfortable. It also allows, amongst others, a body of volunteers to scrutinise these accounts in line with the principles of proportionality and sectoral self-help which informed the establishment of Independent Examination in the first place.

It is therefore surprising that, as a topic for research and writing, the receipts and payments form has received little attention. It was with this in mind that ACIE suggested it as a suitable subject for this study when it was agreed to engage the Centre for Voluntary Sector Research at Sheffield Hallam University to work with ACIE on policy issues over the three years 2005-08.

The range of responses from the surveys which form part of this study are instructive. As many people are strong supporters of the R&P approach as would like to have it committed to history tomorrow. With this in mind and given the likely increase in the upper income limit for charities permitted to present R&P accounts in England and Wales in the near future, policy makers would do well to address some of the issues raised by R&P detractors in this report.

Further, if the R&P regime is to match the claims of its advocates that it provides a robust and proportionate alternative to the demands of SORP compliance for small charities, this report makes some recommendations which need to be given serious consideration

Our thanks go to Professor Gareth Morgan for the enthusiasm and care with which he engaged with the subject and to Sheffield Hallam University for facilitating this study.

Fiona Gordon
June 2008

Executive Summary

The legal framework for charity accounting in England and Wales (E&W) in operation since 1996 allows charities up to £100,000 income (other than charitable companies) the choice of two forms of presentation of their year end financial statements:

- **the receipts and payments (R&P) basis, where the main figures simply record money received and paid out – although a statement of assets and liabilities (SOAL) is also needed; or**
- **the accruals basis, following the Statement of Recommended Practice on Accounting and Reporting by Charities (the Charities SORP – this basis is compulsory for larger charities).**

Similar choices up to £100,000 income now also apply for charities in Scotland. But to date, most research on charity accounting has focussed on the SORP regime, with little consideration of the R&P basis.

This study explores the nature of the R&P regime in terms of its requirements and applicability, and seeks the views of two major groups of stakeholders: (a) independent examiners (IEs), involved in the preparation and external scrutiny of charity accounts and (b) grant-making charitable trusts, considering the accounts of smaller charities in support of applications for funding. Questionnaires were circulated to 559 and 353 potential respondents respectively, seeking views on the level of agreement with various statements concerning R&P accounting by charities.

Detailed findings from both studies are reported, both in quantitative terms and by means of a qualitative analysis of narrative comments. Insights are also included from regulators and from charity staff and trustees.

The main conclusion is that the R&P regime elicits a wide range of views, both from IEs and from funders, with no clear consensus. Some are keen to encourage smaller charities to take advantage of the simplicity of the R&P regime, but others believe the R&P basis has fundamental problems, and wish to see even the smallest charities using the accruals/SORP basis for their accounts. However, both the IEs and the funders give a similar breadth views on each statement. Furthermore, this wide range of views on R&P is held both by professional accountants and non-accountants.

The study identifies some of the significant problems with the R&P regime, especially the lack of clear regulation in E&W and uncertainty about the SOAL and general understanding of what is needed. But it endorses the principle of a simpler regime for smaller charities as an alternative to the SORP/accruals framework. It makes practical recommendations to address the perceived difficulties with the R&P basis, raising proposals for legislation, for charity regulators, for the accountancy profession, and for training work in the voluntary sector.

1. Introduction and Aims of the Study

This is a report of a study commissioned by the Association of Charity Independent Examiners (ACIE) and undertaken by the Centre for Voluntary Sector Research at Sheffield Hallam University (SHU CVSR) exploring a range of issues concerning the use of the **receipts and payments format** (R&P) for presentation of charity financial statements.

1.1 The Issues

All UK charities, whatever their size, are required to publish accounts each year (in most cases, accompanied by an annual report) and these are public documents – available to anyone on request. Charity accounts and reports are used by a wide range of people – the charities themselves (trustees, staff, volunteers), their members and supporters, funders, regulators – and indeed by anyone at all who has any interest in a charitable organisation. Since the early 1990s, legislation has specified what these document must contain. Except for the very smallest charities (those with under £10,000 income in England & Wales) the accounts must be subject to external scrutiny by an independent examiner or auditor.

As explained below, the R&P option is generally available for charities with incomes up to £100,000[1], provided they are not structured as companies. This is an alternative to presenting accounts on an accruals basis, following the Charities SORP (*Statement of Recommend Practice on Accounting and Reporting by Charities*).

Although not compulsory, the R&P presentation is intended to offer a simpler approach for smaller charities, allowing them to prepare accounts and have them independently examined without requiring the level of financial skill needed with SORP-compliant accounts. (However, it should be noted that the upper limit for independent examination of accounts is normally £500,000 income – considerably more than the £100,000 upper limit for R&P accounts, so most independent examiners need to be able to handle accruals-based/SORP accounts, not just accounts on the R&P basis. See section 2.1 for more on thresholds.)

However, when this study began it was clear from anecdotal evidence that there was much uncertainty surrounding R&P accounts, both in terms of the technical requirements and the circumstances in which they were acceptable to external parties such funders. Also, these uncertainties seemed to lead to some concerns from auditors and independent examiners regarding R&P accounts – for example, if an independent examiner was asked to report on R&P accounts which appeared to be numerically correct but presented in a highly confusing way, should this be seen as grounds to require amendment of the accounts or to issue a qualified independent examiner's report?

This study, which has developed over the three year period 2005-2008, has sought to explore these issues, and in particular to address the following aims:

- **to document clearly the legal framework for R&P accounts**
- **to explore what is needed, in practice, in R&P accounts**

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[1] This threshold may be raised to £250,000 in England & Wales as a result of a recent consultation regarding financial thresholds (Cabinet Office and Charity Commission 2007). An analysis of responses shows mixed views on this increase, with a number of voluntary sector bodies expressing serious reservations, but on balance the Board of the Charity Commission has supported an increase. However, any changes to legislation are a matter for Ministers, and no decision had been taken by the time this study was completed. There are no immediate plans to change the threshold in Scotland.

- **to study a range of charity accounts prepared on the R&P basis**
- **to assess the views of key stakeholders on the use of R&P accounts by smaller charities** (i.e. the acceptability of R&P as opposed to requiring even the smallest charities to prepare SORP-compliant accounts).

The study did not specifically seek views on the threshold up to which R&P accounts should be permitted, as this was taken as read from the legislation, but in fact a number of insights emerged on this issue as summarised in later chapters.

1.2 Structure of the Report

The next chapter explores the legal context and broader insights from the accounting literature on this issue. Chapter 3 then summarises the author's understanding of the legislation in terms of what is actually *required* in R&P accounts.

Details of the research methods used are explained in chapter 4 – including the two surveys which were used to capture opinions. Chapter 5 reports the opinions of charity accountants and independent examiners, based on a survey of ACIE members. Chapter 6 outlines the opinions of funders, drawing on a survey circulated to grant-making charities belonging to the Association of Charitable Foundations (ACF). Chapter 7 analyses the results of the surveys in relation to other findings from the study. Chapter 8 summarises the main conclusions and identifies policy implications.

2. The Choices in Charity Financial Reporting: Receipts & Payments or Accruals

2.1 The Legislative Background – England & Wales

Part VI of the Charities Acts of 1992 (as re-enacted in the Charities Act 1993, amended in 1994/95 and eventually implemented for accounting years beginning on or after 1 March 1996) created, for the first time in the England and Wales, a statutory framework for the presentation of charity accounts.

Further amendments have been made as a result of the Charities Act 2006, though they do not affect the issue in this study – however, a recent consultation document (Cabinet Office/Charity Commission 2007) has raised the possibility of increasing the £100,000 upper limit for R&P accounts. So it remains a critical issue.

This framework has become extremely important to the charity sector – indeed it was argued (Morgan 1999) that even in the first three years the regime has led to a fundamental change in the roles of charity treasurer and bookkeeper.

However, it was recognised long before the proposals found their way into legislation – in the Woodfield report considering a new regulatory framework for charities – that the smallest charities could not be expected to produce accounts to the same standards as the largest (Woodfield 1978).

As a result, a series of thresholds was established, mostly based on the income of a charity: as the income of a charity increases, the requirements for financial reporting and for independent scrutiny of the accounts increases. For most of the period covered by this study the main requirements for non-company charities in England and Wales were as summarised by table I[2].

Table I: Summary of minimum accounting requirements
(for non-company charities in England & Wales during the period of this study)

Income	*Presentation of Accounts*	*Scrutiny of Accounts*
Up to £10,000	Receipts and payments basis	Approval by trustees only
£10,000 to £100,000	Receipts and payments basis	Independent examination
£100,000 to £250,000	Accruals basis following Charities SORP but with a few simplifications permitted	Independent examination
Over £250,000	Accruals basis following Charities SORP in full	Audit

[2] A number of these requirements have now changed – in particular, for accounting years beginning from 27 Feb 2007, the audit threshold is increased to £500,000 – however for charities over £250,000 income the independent examiner must be professionally qualified. Also, additional requirements now apply in certain cases for charities with over £2.8M assets, and for charities with subsidiaries. However, none of these changes affects the threshold for R&P accounts.

It is seen that two separate regimes of financial reporting were established (see Morgan 2002 and 2008 for further details).

The normal requirement, under s42(1) of the Charities Act 1993, requires charity trustees to prepare for each financial year "a statement of accounts complying with such requirements as to its form and contents as may be prescribed by regulation made by the Secretary of State". There have now been four such sets of regulations – *The Charities (Accounts and Reports) Regulations 1995, 2000, 2005*, and *2008* – and in each case the regulations have required the accounts to comprise:

- a statement of financial activities (SOFA)
- a balance sheet
- and notes

– in each case following the principles set out in the relevant version of the Charities SORP (Charity Commission 1995, 2000, 2005). The regulations also require that the statement of accounts must be prepared to give a "true and fair view" – meaning (amongst other things) that the figures need to be presented on an accruals basis (see below for clarification of these terms).

However, s42(3) of the 1993 Act allows the trustees of non-company charities below £100,000 income to opt to produce accounts on a receipts and payment basis (R&P)[3]. In such cases the accounts must comprise:

- a receipts and payments account (R&P account)
- and a statement of assets and liabilities (SOAL).

Unlike accounts on the first basis, the legislation does not allow any detailed regulations to be made for accounts under s42(3) – this is explored further below. So, whilst the Charity Commission offers *guidance* on the preparation of R&P accounts[4], there is nothing in law to say what the "receipts and payments account" and the "statement of assets and liabilities" (SOAL) must actually include, or how they must be set out.

It is important to note that charities must *use one or other* of these forms of accounting – *either*:

- the R&P basis
  or
- the accruals basis (following the Charities SORP presentation)

– there is no provision in law for any halfway house: a charity under £100,000 income must choose one basis or the other. (However, this is not always well understood, and from examples of accounts filed at the Charity Commission, there are plenty of ambiguous cases - see Morgan 2005a, 2005b).

It should be noted that the option of presenting accounts on an R&P basis does *not* apply to charitable companies. The accounts of charity which is a company must be prepared to

[3] The full wording is reproduced in Appendix A.
[4] For the latest guidance, see publication CC16 (Charity Commission 2006).

comply with company law, which requires a true and fair presentation even for the smallest companies – however the Charities SORP is applicable. Hence charitable companies always need to produce financial statements on the accruals/SORP basis.

The remainder of this paper will therefore concentrate entirely on non-company charities[5] under £100,000 income where the possibility of R&P accounts exists. This typically includes charitable trusts (governed by a declaration of trust), charitable associations (governed by a constitution) and a wide range of charities governed by other legislation or by Royal Charter. It also includes bodies such as Parochial Church Councils (PCCs) in the Church of England which have a corporate form but are not subject to company law.

It should be noted that the new legal form of a *Charitable Incorporated Organisation* being introduced under the Charities Act 2006 (see Morgan 2007) is a non-company form, and hence it is expected that R&P accounts will be permitted for CIOs below £100,000 income. However, the legislation for CIOs had yet to be implemented at the time of this study.

2.2 The Legislative Background – Scotland

For charities established under Scots law, the first rules on the presentation of charity accounts arose from the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990. The detailed requirements under the 1990 Act were set out in the Charities Accounts (Scotland) Regulations 1992.

The underlying principles were very similar to England and Wales (E&W), allowing the smallest charities to produce accounts on an R&P basis, with a larger charities being required to prepare accounts on an accruals basis. However, unlike E&W, the thresholds were not altered for over a decade, so R&P accounts were only permitted up to £25,000 income (and, as in E&W, did not apply to charitable companies).

The 1992 Scottish Regulations pre-dated the Charities SORP, and so the requirements for accruals accounts were somewhat confusing as they still required an income and expenditure account rather than a statement of financial activities (SOFA) – also the breakdown of headings in the income and expenditure account do not tie in well with the requirements of the SORP.

However, in the case of R&P accounts, the requirements were much more explicit than in E&W. Two statements were required:

- a receipts and payments account
- and a statement of balances

– but the 1992 regulations were quite explicit about the categories needed in the R&P account, and about various notes which had to be included, even with accounts prepared on the R&P basis. The statement of balances was similar in concept to the SOAL in E&W.

However, for the following decade, there was little regulation of charities in Scotland, and no general requirement for Scottish charities to file accounts. The Office of the Scottish Charity

[5] Much writing uses the term "unincorporated charities" but this is misleading – as this paragraph indicates, some charities such as PCCs are corporate bodies, but they are *not* companies – so R&P accounts are permissible.

Regulator (OSCR) – was not established until late 2003 (initially as an agency of Scottish Ministers, but then given a statutory basis under the Charities and Trustee Investment (Scotland) Act 2005). This, combined with the fact that the R&P regime was only applicable to very small charities under £25,000 income, makes it difficult to assess the impact of the 1992 Scottish R&P regime.

For accounting years starting on or after 1 April 2006, Scottish charities became subject to a new accounting framework – the Charities Accounts (Scotland) Regulations 2006 made under s44 of the 2005 Act.

The Charities Accounts (Scotland) Regulations 2006 largely aligned the thresholds in Scotland with those for E&W following the Charities Act 2006 – thus R&P accounts were permitted up to £100,000 income, and the audit threshold (the upper limit for independent examination) was increased from £100,000 to £500,000.

The 2006 Regulations followed the same principle as the 1992 regulations in requiring that R&P accounts should comprise an R&P account and a statement of balances – but as previously in Scotland, and unlike the position in E&W, *the regulations give full details of the analysis or categories of information required.*

The Scottish regime is thus unique in the UK at the present time in providing this detail for R&P accounts and the relevant regulations are thus reproduced in full in Appendix A.

2.3 Application of the R&P Regime

In England and Wales, some 85% of charities[6] on the Charity Commission Register have incomes under £100,000 (figures taken from Charity Commission 2008) – amounting to approximately 145,000 organisations. Only around 12,000 of these are structured as companies[7] - so around 133,000 charities – some 79% of those on the register – are potentially able to use the R&P format.

Moreover, the E&W charity accounting regime also applies to excepted charities (the largest groups within this are churches and armed forces charities). There are no clear figures for excepted charities, but in both cases, it is estimated (Cabinet Office 2008) that very few of these are structured as companies and only a small minority have incomes over £100,000. Hence the R&P regime can also be used by the vast majority of E&W excepted charities.

For charities registered in Scotland[8] (OSCR 2006), the proportion of charities under £100,000 income is also 85% – some 20,000 organisations – and no more than 3,400 of these are companies[9], so around 17,000 Scottish charities can use the R&P basis.

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[6] Figures are based on "main charities" – i.e. excluding charities which are registered as subsidiaries of other charities and which do not normally therefore have to produce accounts in their own right.

[7] Estimated figure extrapolated from government statistics (Cabinet Office 2008). Also, data presented by a member of the SORP Committee (Allock-Tyler 2008), apparently from Charity Commission internal data, gives the following figures for registered charities in E&W: under £10,000 income – 114,600 charities of which 6% are companies (6,876); £10,000 - £100,000 income – 50,700 charities of which 14% are companies (7,098). This gives 13,974 charitable companies under £100,000 income. However, Allcock-Tyler's figures appear to be based on all charities on register under £100,000 income (total 165,300) – not just the "main charities" (144,412 – from Charity Commission 2008). The main charities form 87% of the total register under £100,000 income. Assuming the incidence of "main" and "subsidiary" charities is unaffected by legal form, this would suggest that around 12,000 main charities under £100,000 income are companies.

[8] The figures include some charities which are dual registered – i.e. registered in Scotland as well as E&W.

[9] OSCR data provided to ACIE indicates that in 2007 17% of Scottish charities were companies.

Overall, therefore it is clear that something like **80% of all UK charities are entitled to produce accounts on the R&P basis** – amounting to at least 150,000 organisations in total.

Unless a high proportion of these charities were voluntarily choosing to follow the accruals/SORP basis – and studies of accounts filed at the Charity Commission do not suggest this[10] – it is clear, therefore, that **the R&P basis is the dominant form of charity financial reporting in the UK**.

However, most research consideration of the UK charity accounting regime (e.g. Connolly & Hyndman 2000 & 2001, Palmer et al 2001; Palmer & Randall 2002) focuses purely on the regime as its applies to charities subject to the SORP. There has been relatively little consideration of charity financial reporting on the receipts and payments basis. Textbooks on charity accounting (e.g. Morgan 2008, Pianca & Dawes 2002) give some consideration to the R&P regime, but it does not appear to have received any significant consideration from a research perspective prior to the present study.

2.4 Accounting Concepts – R&P or Accruals Basis and the Implications for Charities

It is generally acknowledged in the accounting literature that one of the central roles of accounts – financial statements – is to present a "true and fair view" of the financial position of the entity concerned. This demands accounts where the figures are computed on an accruals basis – recording income earned over the period concerned and costs incurred. The income and expenditure statement prepared on this basis is linked to the balance sheet, which presents a snapshot of the entity's total resources, recognising not just monetary assets, but also assets in the form of debtors and fixed assets, and liabilities in the form of creditors (whether short or long term).

The definition of the accruals concept in UK accounting standards is as follows:

> *Revenue and costs are accrued (that is, recognised as they are earned or incurred, not as money received or paid), matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate; provided that where the accruals concept is inconsistent with the prudence concept, the latter prevails.*[11]

By contrast, receipts and payments accounts can offer a factual presentation of the monetary receipts and payments of an entity, but they will rarely show a true and fair position unless the actual timing of receipts and payments directly corresponds with the dates when the entity became entitled to income, or accepted obligations in relation to expenditure. It is possible in a very small organisation, that the R&P basis and the accruals basis could yield the same results, but only if all the following applied:

- no material fixed assets – i.e. all expenditure was on short term items
- no material debtors – neither at the start of the year nor at the end
- no material creditors – neither at the start of the year nor at the end
- no other material non-monetary assets or liabilities (such as stocks or provisions).

[10] For example, the work reported in Morgan (2005).

[11] SSAP2 para 14(b). The significant of this definition is highlighted by Jones and Pendlebury (2000) in discussing the adoption of accruals accounting in the public sector.

Because these conditions will only apply to the very simplest entities, the use of R&P accounts receives little or no considered in the majority of accounting texts. They may discuss the use of a cash book as a basis for initial postings, but not for financial reporting. Most cover the fundamental accounting concepts without even seeking to address the relative merits of cash-based accounting and accruals accounting. This seems to be the case even though they generally recognise the role of cash flow statements prepared under FRS1 for larger entities.

However, it remains the case that many non-accountants lack any understanding of the essential recognition principles in accruals accounting. Many proprietors of owner-managed businesses or treasurers of voluntary organisations maintain only cash-based records and the routine work of preparing financial statements involves an accountant adjusting these figures to allow for year end debtors and creditors, capitalisation and depreciation of fixed assets, etc. In these circumstances, the option of preparing accounts on an R&P basis is potentially very attractive.

In the charity context, the R&P basis would appear to allow many charity treasurers to prepare end of year accounts without the assistance of a professional accountant. It also reduces considerably the level of expertise needed for someone called upon to act as an independent examiner to a small charity.

2.5 Assessing the R&P Basis

But in assessing the R&P basis, it has to be asked whether the end result – the financial statements produced – are more useful to end users if prepared on the accruals/SORP basis, or on the R&P basis It is not unusual for accountants to devote considerable effort to producing financial statements on an accruals basis which mean little to those who have to approve them, and to get questions, for example, as to why a debtor has been included in the income statement even though the funds are yet to be received, or why the balances carried forward appear to include money which has already been spent on purchases of fixed assets.

In the case of small businesses, one justification for the accruals basis may be in the requirement to compute profit figures on a true and fair basis to satisfy the tax authorities. But in the case of charities this argument does not apply given that charities will normally be exempt from taxes on profit or gains.

Another answer might be in the requirements of company law, but it is worth noting that it is only since 1948 that companies have been required to produce financial statements that give a true and fair view (Pendlebury and Groves 2004). In any case – as discussed above – this requirement does not apply to the majority of smaller charities structured as trusts or associations.

However, whilst the use of accruals accounting for financial reporting by commercial entities now seems to be accepted without question, there has been a long-standing debate about accruals accounting in the public sector (Carlin 2005), with most of the UK public sector only recently moving to this basis. Moreover, there remains an ongoing debate about the needs of the user of public sector accounts (Jones & Pendlebury 2004). Indeed, Jones and Pendlebury (2000, p160) in their book *Public Sector Accounting* comment:

> There is a very serious and respectable literature on cash flow accounting for the business sector … which argues that the traditional accruals accounting statements are too subjective and hide crucial information about organisations' performance. However, no accounting standard-setting body in the world has recognised cashflow accounting as a replacement for accruals accounting.
>
> Cash flow accounting is practised in many public sector and non-profit organisations. The simple receipts and payments accounts of the small charity are probably the most common example; whilst perhaps the most important (certainly in terms of amounts of money accounted for) are the cash accounts of most sovereign governments.

Nevertheless, the late 20th century and first decade of the 21st century has seen a major move towards public sector accruals accounting in many countries (see Christiaens & Rommel 2008 for a history of the debate). In the UK, as part of the programme for "Whole of Government Accounts" (WGA), the Government is committed to introducing accruals accounting following Generally Accepted Accounting Practice (GAAP) as widely as possible in the public sector. This programme began with a scoping study in 1998, and by 1995 it was reported that "All major public sector bodies in the UK now prepare accruals accounts" (HM Treasury 2005, para 2.40) – although issues were still being resolved in relation to certain public sector assets.

Charities arguably fall mid-way on the spectrum between public sector bodies and private businesses. On the one hand, they are clearly public-interest entities, holding funds for public benefit, and charities, like public sector organisations, are established on a not-for-profit basis. On the other, most charities are run by small numbers of individuals, and, especially at the smaller end, would be seen for most purposes as private organisations.

So, in 1992, when the legislation on charity accounting was being enacted, most of the public sector was using cashflow accounting (even though businesses were accounting under GAAP) so there were potentially good arguments for allowing cashflow (R&P) accounting to be used in charities, at least at the smaller end. The sort of accounts which most charities would have been producing at that time would normally have been prepared on an R&P basis, except for the very largest charities seeking a professional audit.

Indeed, for medium sized charities which became subject to the SORP regime from 1996, it was found that one of the biggest challenges experienced by many treasurers and bookkeepers was not the SORP presentation (the SOFA layout is not difficult to understand) but the need to present figures on an accruals basis, taking account of debtors, creditors and depreciation (Morgan 1999). The introduction of the new charity accounting regime which took effect from 1996 had a huge impact – but overall, the vast majority of charities accepted the essentials of what was required, although there were many complaints. But to have forced even the smallest charities into accruals accounting and SORP compliance might well have let to outright rebellion and/or the collapse of vast numbers of smaller charities.

2.6 Implications for the Study

A key question for this study is thus to consider whether the position has changed, after more than a decade since the current regime was introduced.

- It could be argued that now that there is considerable familiarity with the SORP regime that it would not be unduly onerous to begin expecting even charities below £100,000 to comply – this was the view of some respondents to the surveys reported below.

- On the other hand, it could be argued that now there is a clear regime for independent examination of charity accounts, that the R&P format is subject to sufficient checks that it could safely be extended to a wider range of charities, and that the £100,000 upper limit might be increased – this seems to be the view argued by in the recent consultation *Financial Thresholds in the Charities Acts* (Cabinet Office & Charity Commission 2007, paras 5.3.1-5.3.6).

These issues are explored further in the remaining chapters of this report.

3. Receipts and Payments Accounts: The Practical Requirements

3.1 Determining the Requirements

From the literature above, it is a clear that there are several fundamental “difficulties” with R&P accounts.

(a) **It is unclear exactly what is needed for acceptable financial statements on the R&P basis.** This is especially the case in England and Wales where there are no regulations on the content of charity accounts on the R&P basis.

All the established body of accounting standards apply to the accruals basis – whether UK-based (GAAP) or international (IFRS). The situation was partly remedied in SORP 2000 (Charity Commission 2000) by the inclusion of two pages of material – paras 350-356 – setting out what was expected for charity R&P accounts. Given that the SORP was accepted by the Accounting Standards Board (ASB) this provided, for a limited time, a formal standard for charity R&P accounts. But no equivalent material was included in SORP 2005 – the author understands that the ASB was unhappy about material on R&P accounting being included in the SORP given that SORPs are intended to support the presentation of accounts on a true and fair basis by tying into general accounting standards in the context of a particular industry.

This situation is less problematic in Scotland due to the clear requirements for R&P accounts in the Charities Accounts (Scotland) Regulations 2006 – see Appendix A – but since that regime only took effect for accounting years commencing from April 2006, few of those responding to the surveys in this study would have had experience of Scottish R&P accounts following the 2006 Regulations, and until the creation of OSCR there was little pressure for smaller Scottish charities to follow the former 1992 Regulations.

In E&W, the strongest “formal guidance” currently application to R&P accounts is the publication CC16 *Receipts and Payments Accounts Pack* (Charity Commission 2006). Although this pack includes eight pages of “Introductory Notes” (CC16b), which are certainly very helpful to anyone preparing financial statements on the R&P basis, the notes make clear that they are no more than guidance on the principles. Unlike other CC publications, which frequently include legal requirements identified by the word “must”, this word does not appear anywhere in the text of CC16b in the context of instructions to the charity trustees.

Similar guidance (but with slightly more detail) has been produced for Scottish Charity Accounts on the R&P basis (OSCR 2008), but unlike the E&W guidance, this uses the term “must” on many occasions, as a result of the requirements for R&P accounts under the 2006 Regulations.

(b) **Hence, there is much less standardisation in the presentation of R&P accounts.**

A major advantage of the SORP framework is the requirement for all charities to use similar layouts in the presentation of their financial statements (SOFA and balance sheet) and similar disclosures in the notes. It became clear from the surveys reported in the later chapters that this framework is valued by those involved in preparing and independently examining charity accounts, and by users of accounts (such as funders).

It is much harder to compare the accounts of two charities using R&P accounts – for example:

- One charity may have presented each fund on a separate page, whilst another may have used a columnar format, similar to the SOFA.
- One charity may have included in the R&P account for each fund the final balance on each fund – another may have included fund balances only on the SOAL.
- One charity may have provided full prior year comparisons for each figure – another may not have given any prior year information.
- One charity may have provided a comprehensive SOAL, with estimated values for all items including fixed assets giving almost as much information as on the asset/liabilities side of a balance sheet – another may have provided no more than a crude list of assets similar to an inventory.
- One charity may have provided comprehensive notes in support of the R&P account and SOAL – another may have provided no notes whatsoever.
- One charity's entire accounts (R&P account and SOAL) may be presented on a single page – for another charity there may be five or six pages of accounting information.

Each of these approaches is legal in England & Wales – for each of the bullet points shown it is impossible to say one charity is "better" than the other in terms of compliance with the requirements – both are equally valid. Moreover, these variations only take in account legitimate ways of preparing R&P accounts – studies by the author of accounts filed with the CC show that many charities below £100,000 income produce accounts which fall short even of the minimum requirements of the law[12].

(c) **For independent examiners and auditors, the lack of clarity on the minimum requirements can make it harder to decide whether or not a qualified report is needed.**

Smaller charities using the R&P are probably more likely to prepare the accounts themselves and just approach an independent examiner (IE) to report on their accounts – whereas charities using the accruals/SORP basis are more likely to need the help of an accountant or IE in preparing the accounts.

This greater simplicity in the preparation is one of the main advantages of the R&P basis – but it can present significant problems for IEs. It is quite common for a small

[12] Partly reported in Morgan (2005b); additional data held by author.

charity to present accounts for scrutiny which the IE regards as quite "scrappy". In such cases, the IE has to make a judgement whether:

- to insist on amendment of the accounts to meet the standard the IE expects (refusing to issue an IE report until this is done) – or
- to issue a qualified IE report (for example, the examiner's report could include a long "draw attention to" comment, highlighting matters of which the IE feels the reader should be aware, but which the charity did not disclose) – or
- to issue a normal unqualified IE report on the grounds that the accounts just about meet the legal minimum even though the figures may be poorly presented to the extent that readers would have difficulty making sense of the accounts.

These possible "difficulties" with the R&P basis areas are explored further in the fieldwork reported in the following chapters in order to assess how far they are or are not perceived as problems.

As noted, these difficulties are, for the most part, specific to England & Wales, but it is too early to assess whether the 2006 Regulations in Scotland are sufficient fully to overcome these issues, as few charities registered in Scotland would have completed their first accounts under the new regulations at the time of the fieldwork in this study[13]. Hence, the surveys in this study do not attempt to distinguish between the different jurisdictions.

3.2 Assessing the Minimum Legal Requirements for R&P Accounts in England & Wales

Given the issues noted above, it would seem helpful to set out a normative view of what is *essential* for charity accounts prepared on the R&P basis under the E&W requirements.

As explained in chapter 2 the only specific requirement under the Charities Act 1993 is that for a charity with income not exceeding £100,000 and where the trustees opt under s42(3) for the R&P basis[14], the accounts must comprise:

- a receipts and payments account, and
- a statement of assets and liabilities.

These terms are not defined further in the Act, and hence any discussion of what is *essential* for accounts on the R&P basis depends on the interpretation of these terms.

However, this could potentially be tested in court. Section 45 of the 1993 Act requires trustees of registered charities to prepare an annual report and to transmit this to the Charity Commission *together with the statement of accounts* (and the report of the auditor or independent examiner) within ten months of year end (although charities up to £10,000 income only have to file the report and accounts if the CC explicitly requires them). Under s49, trustees failing to do so are guilty of an offence, and could face fines up to level 4 (currently £2,500). So, it is possible to envisage a situation in which trustees of a charity are

[13] The 2006 Scottish Regulations took effect for accounting years commencing on or after 1 April 2006. So, even for charities with a 31 March year end, the first full accounting year under the new Regulations was the year ending 31 March 2007, for which accounts had to be filed with OSCR by 31 December 2007. For Scottish charities with other accounting years, the deadline for filing the first set of accounts with OSCR under the 2006 Regulations could be as late as 30 December 2008.
[14] See Appendix A for the text from the Act.

facing prosecution for failing to file proper accounts, but in their defence they argue that they submitted what they believed was sufficient. The Court would then have to judge whether or not what they had actually submitted constituted an R&P account and a SOAL as required by the Act.

Clearly, however, the Act is requiring two separate financial statements, and *other material* in the 1993 Act may help to unpack what is required in each of these.

Section 41 of the Act spells out the requirements on charity trustees with regard to the keeping of *accounting records.* The relevant subsections state:

> *41(1) The charity trustees of a charity shall ensure that accounting records are kept in respect of the charity which are sufficient to show and explain all the charity's transactions, and which are such as to—*
>
> *(a) disclose at any time, with reasonable accuracy, the financial position of the charity at that time, and*
>
> *(b) enable the trustees to ensure that, where any statements of accounts are prepared by them under section 42(1) below, those statements of accounts comply with the requirements of regulations under that provision.*
>
> *(2) The accounting records shall in particular contain—*
>
> *(a) entries showing from day to day all sums of money received and expended by the charity, and the matters in respect of which the receipt and expenditure takes place; and*
>
> *(b) a record of the assets and liabilities of the charity.*

From this several points emerge:

- The reference in s41(1)(b) implies that most charities must keep sufficient records as to enable accounts to be prepared under s42(1) – this refers to the "normal" statement of accounts on an accruals/SORP basis. The trustees can only ignore this paragraph if they are *certain* that there is no chance at all that the charity might have to prepare full accounts under s42(1). Given that the total income of the charity can never be known until year end, even trustees *expecting* to use the R&P basis, would be well advised to keep sufficient records so that accruals accounts could be prepared if necessary.

- Under s41(2)(a) the records must record all receipts and payments including the matters in respect of which the receipt or expenditure[15] takes place. So, a simple list of amounts and dates would not do – there must be some record of the *purpose* of all receipts and expenditure. So, if the R&P account prepared at year end is to reflect the accounting records, it must surely make at least some attempt to categorise the receipts and payments in a meaningful way following the purposes recorded against the individual transactions.

- The clear requirement in s42(2)(b) that the records must contain "a record of the assets and liabilities of the charity" makes clear that a charity cannot *just* keep monetary records of receipts and payments. There must be sufficient information to prepare a SOAL at year end. Moreover, under s41(1)(a) those records must be sufficient to disclose the financial position of the charity with reasonable accuracy "at any time".

[15] It is perhaps curious that the legislation uses the terms "sums or money received and expended" rather than "receipts and payments", but the term "money expended" can hardly be considered to apply to expenditure which is recognised purely as a creditor. So, it is assumed that these terms refer to monetary receipts and payments as widely understood.

Hence, for example, records of debtors and creditors need to have clear dates as to when a debt arose and when it was discharged and the SOAL can therefore be quite precise as to whether or not a particular liability existed at the year end date. However, it should be noted that there is no specific requirement to record the value of assets or liabilities, so a SOAL which simply lists the charity's main assets and liabilities would appear to be sufficient to reflect the underlying records.

It seems extraordinary that nothing specific is included in the Act regarding fund accounting, but the guidance in CC16b (Charity Commission 2006) states clearly that this is a requirement of trust law:

> *Trust law requires that trustees should be able to account separately for each restricted, endowment and unrestricted fund that they manage. However, a separate bank account is not required for each fund provided that the bookkeeping records (for example, cash book and supporting documents) allow the trustees to identify the receipts and payments of each fund and the related assets and liabilities.*

If the trustees are complying with this in their accounting records, and if the R&P account at year end reflects those records, it seems reasonable to accept that it must distinguish receipts and payments related to the different funds of the charity, and similarly the SOAL should distinguish assets and liabilities related to separate funds where material.

The CC guidance takes this view, stating:

> *When preparing year-end accounts, trustees may either:*
> - *prepare a separate receipts and payment account for each fund that they manage; or*
> - *prepare one account to cover all their unrestricted funds, another for all their restricted funds and another for all their endowment funds; or*
> - *combine all three types of fund in a single statement showing each type of fund in a separate column.*

The reporting duties of independent examiners as set out in reg 31 of the Charities (Accounts and Reports) Regulations 2008[16] give further support for this argument that the R&P account and SOAL must reflect what is required in the accounting records. In particular, an independent examiner must state in his/her report if matters came to the examiner's attention suggesting that the accounts do not comply with the accounting records. So, if, for example, a charity maintained records by funds to comply with trust law, but did not reflect any fund accounting in the R&P account at year end and simply lumped all funds together it would surely be appropriate for the IE to issue a qualified report (under reg 31(h)(2)).

Moreover, there is a separate duty (reg 31(j)(i)) on the IE to report if "any material expenditure or action which was not in accordance with the trusts of the charity" became apparent during the examination. So, if a charity was in receipt of donations or grants for restricted purposes, but the trustees made no attempt to keep records on this basis, and spent the income as they wished, the IE would have further grounds for making a qualified report.

It is also worth noting that for registered charities, a trustees annual report (TAR) must be prepared in addition to the accounts. Even for smaller charities, there are very specific

[16] Similar requirements applied under the earlier Regulations of 1995, 2000, and 2005.

regulations[17] on what must be covered in the TAR, and some of these have the effect of amplifying the legal requirements for the accounts. In particular, the TAR must contain a statement of the charity's reserves policy (or a statement that the charity has no such policy) and the policy must give details of any planned expenditure deducted from unrestricted funds to arrive at the reserves level required. So, unless the charity choose not to adopts a reserves policy and is willing to disclose that it has no policy, the TAR will need to identify unrestricted funds and related planned expenditure. This is surely impossible, unless such information is provided in the R&P account and SOAL.

3.3 Summary – What R&P Accounts Must Contain

Taking the above evidence together, we may conclude that in order to comply with the law in England and Wales, a statement of accounts for a charity in E&W prepared on the R&P basis, must contain the at least the following:

(a) A receipts and payments account:

- bringing together all receipts and payments of the charity *over a financial year* (as defined in the Act - normally 12 months)
- broken down into *separate funds* where the charity has any restricted or endowment funds and clearly identifying the level of *unrestricted funds* (as a basis for the reserves policy)
- analysed at least to some extent into categories related to the nature or purposes of the receipts and payments ("the matters in respect of which" they took place).

(b) A statement of assets of liabilities

- bringing together all assets and liabilities of the charity *at a specific point in time* (normally this would be as at the year end date, but this is not mandatory so long as it clearly relates to the financial year concerned)
- broken down into the categories of assets and liabilities in the accounting records – in particular, since the records require separate records of monetary receipts and payments, it should always be possible to distinguish:
    - monetary assets (with a figure)
    - non-monetary assets
    - non-monetary liabilities
- analysed in relation to the funds to which the assets and liabilities relate.

(c) Whilst no specific further information is required, the accounts must be clear enough to make sense to a reader without further amplification, if they are to avoid a qualified IE report in which the examiner draws attention to further information of which the reader should be aware in order "to enable a proper understanding of the accounts to be reached".

However, the following, which many regard as good practice, are clearly *not* mandatory for R&P accounts to comply with the Act:

[17] Charities (Accounts and Reports) Regulations 2008 – reg 40.

- Notes to the accounts are clearly not required (unless the required analysis of the R&P account into funds and into categories of receipts and payments cannot be achieved in the R&P account itself).
- So, no specific disclosures such as trustee expenses or grants made are required (unless it can be argued that they represent fundamental “matters in respect of which expenditure took place”) or unless the IE is convinced that they are crucial issues without which the reader cannot obtain a proper understanding of accounts.
- There is no compulsion to give prior year figures.
- So long as the trustees can provide a reasonable list of all the charity’s assets and liabilities there is no requirement to put values on the SOAL, except in the case of monetary assets where any effective records of receipts and payments would necessarily show current values.

4. Basis of the Present Study: Research Methods

4.1 Key Research Questions

In the light of the research aims identified in chapter 1, two fundamental issues still need to be considered in the debate between the R&P format and the accruals/SORP format for small charities:

- Are R&P accounts actually felt to be simpler by the charities who produce them, and by the independent examiners (and sometimes auditors) who scrutinise them?

- Which format (R&P or accruals/SORP basis) do the main users of charity accounts (trustees, staff, volunteers, supporters, funders, regulators) find most helpful in relation to smaller charities?

4.2 Research Methods

These questions could be explored at many different ways, with different audiences and using a range of research methods. Given the relatively limited resources available for the study, it was decided to focus on four methods of investigation.

(a) It was clear that the opinions of independent examiners were highly relevant to the issue in question – indeed that was one of the main issues which prompted the study in the first place. In many cases, charities also use their accountants and independent examiners (IEs) to prepare their accounts in the required format (starting from the charity's books), as well as to examine them, so the views of IEs are relevant both in relation to the preparation and the scrutiny aspects.

With the support of the Association of Charity Independent Examiners (ACIE) who commissioned this study, it was relatively straightforward to undertake a postal survey of ACIE members. Although not all ACIE members personally act as independent examiners (see figures in chapter 5 from the survey results) all have a significant interest in accounting issues for smaller charities.

The work of IEs is entirely with charities below the audit threshold[18] and thus includes many charities using the R&P format. However, in England and Wales, charities with incomes in the £100,000 to £250,000 range were also eligible for independent examination, but were obliged to use the accruals/SORP format – hence it was expected that many IEs would have experience of both regimes, and be able to comment meaningfully on the issues in this study.

ACIE members are not necessarily "typical" independent examiners – the mere fact that they have chosen to join a body like ACIE is an indication of commitment to professional standards and a desire to keep up to date in the field of charity accounting. However this involvement in the issues increases the value of their comments.

[18] At the time of the study this was £250,000 income in E&W and £100,000 in Scotland, but subsequently increased to £500,000 income in both jurisdictions.

This survey was circulated in February 2006 to 559 ACIE members – see Appendix B for full details of the questionnaire. A total of 240 responses were received by the deadline for analysis, giving a response rate of 43%.

See chapter 5 for the findings from the ACIE survey.

(b) The second key perspective was that of *users* of charity accounts, and within the category of users it was felt that the perspective of *funders* was of particular importance. The extent to which funders prefer R&P accounts or accruals/SORP accounts from smaller organisations applying for funding is an extremely important factor in considering the usefulness of the two formats.

Within the broad category of funders, it was known that there is considerable interest in the accounts of applicants amongst grant-making charities which belong to the Association of Charitable Foundations (ACF) – ACF is the UK's umbrella body for charitable grant-making bodies. ACF has, for example, regularly offered courses on "Reading Applicants' Accounts". Also, the fact that ACF members are in almost all cases charities themselves means that they have a measure of familiarity with charity accounting which is not necessarily the case with (say) a local authority grant-maker.

A survey to ACF members was circulated in November 2007 – the total mailing was 353, though this includes some non-members who received ACF publications, and some members have mailings to more than one person. A total of 24 responses were received by the deadline for analysis: at first sight this is only a 6.8% response rate. However unlike the ACIE mailing, this was sent out as one piece of paper in a large ACF mailing so it was easy for the questionnaire to be discarded. Also, there are a significant number of ACF members to whom the issue was completely irrelevant – many have grant-making policies which would not include small voluntary organisations as potential recipients (e.g. those supporting medical research, or to major arts bodies, or grants to individuals).

Also, even for those who do make grants to small charities, not all will consider applicants accounts as part of the process, and may well have considered the survey irrelevant. Even for those which do, it may be no more than a box-ticking exercise, where the accounts are not actually read.

There is no way of quantifying these issues accurately, but it is suspected that at most a third of ACF member organisations are both (a) directly involved in grant-making to small charities and (b) routinely ask for applicants accounts. If this assumption is correct, a response of 24 represents over 20% of the relevant population.

Despite the small numbers, the quality of these responses was very high. Many had taken the trouble to add additional comments and were clearly very interested in the issue of what they wanted to see in applicants' accounts.

So, whilst great care is needed in the use of any statistics from such a small number of responses, qualitatively this survey provides some very valuable data. It gives some insights into the use of applicants accounts by charitable funders who actually take a detailed interest in the accounts received from small charities seeking funding.

See chapter 6 for the findings from the ACF survey.

(c) The third perspective is the use of charity accounts by *regulators* – e.g. the Charity Commission and OSCR.

Much of the insights from this were gained from study of guidance from the Charity Commission (CC) and OSCR on the requirements for charity – but this was supplemented by a number of informal conversations on various occasions during the research with senior CC staff. Account was also taken of the CC's published Operational Guidance in relation to charity accounts and of the CC's own published study on charity accounts – albeit based on larger charities (Charity Commission 2004).

However, soon after the study began, it became clear that the CC no longer had the resources to continue regular reviews of accounts received from registered charities, except in the case of the largest organisations.

Nevertheless, it is known that when some concern or issue is raised in relation to a particular charity, the CC makes considerable use of the latest available accounts – especially if consideration is given to opening a formal Inquiry under s8 of the 1993 Act or the use of enforcement powers. The author has assisted a small number of charities who have undergone s8 Inquiries and many of the questions raised by the CC's officers derive from issues in the published accounts.

In the case of OSCR, the regular process of requiring Scottish charities to submit their accounts to OSCR only began mid-way through this study. Nevertheless, the formal guidance from OSCR on charity accounting – especially the guidance on Scottish R&P accounts published towards the end of this study has been considered (OSCR 2008).

However, even where the CC or OSCR does not directly review a charity's accounts, all registered charities are required to complete an annual return or database update with details of their annual income and expenditure, and additional financial information in certain cases such as benefits to trustees. Charities completing their returns will normally obtain such information from their published accounts.

The findings from this aspect of the study are integrated into the discussion in chapter 7.

(d) The fourth perspective is that of charities themselves.

Over the period of the study (and previously since 1995) the author has conducted a wider range of seminars on the subject *Understanding the Charity Accounting Rules* which has sought to explain the regime and, in particular, the differences between the two forms of charity financial reporting. The participants in these seminars – amounting to over 300 individuals – comprise a mixture of charity staff and trustees (and a few external advisers).

Many of these were working in small/medium charities with limited resources. A number of the seminars were conducted, by invitation from local umbrella bodies, in areas with a considerable level of social and economic disadvantage, where voluntary organisations had little access to financial skills. Around 20% of participants were from the church sector – generally representing charities excepted from registration.

These events were not used formally for research purposes, but opinions were sought from participants regarding their perceptions of the R&P regime and the SORP/accruals regime, in terms of the implications for preparing accounts for their own organisations, or in terms of working with external accountants or independent examiners.

The findings from this aspect of the study are integrated into the discussion in chapter 7.

5. The Views of Charity Accountants and Independent Examiners

5.1 Issues Explored

As explained in the last chapter, the principal means of gaining opinions from those who act as independent examiners (or who are otherwise involved with the preparation of small charity accounts) was by means a postal survey of ACIE members.

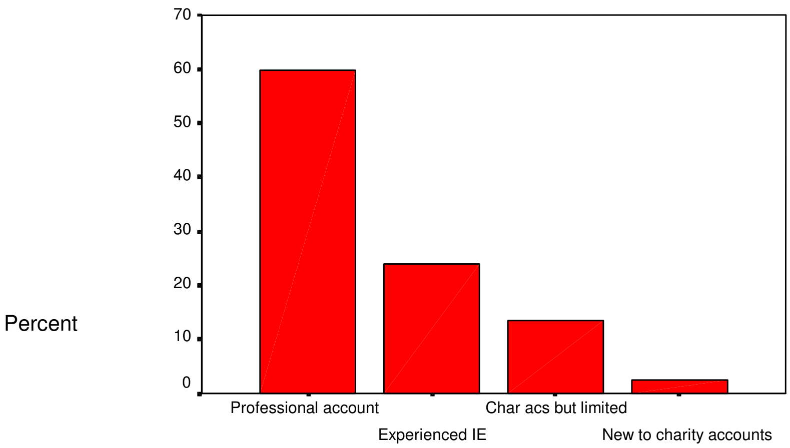
The survey form was kept to a two-page questionnaire which is reproduced in Appendix B. It comprised:

- a short section gathering quantitative data about respondents in terms of the numbers of sets of charity accounts with which they deal, and within this, how many were on each basis (R&P or accruals)
- a serious of 11 statements regarding R&P accounts (or conversely, regarding accruals/SORP accounts) about which respondents were invited to express their opinions on a five point Likert scale (from “strongly disagree” to “strongly agree”)
- space for respondents to add additional narrative comments (discussed in chapter 7)
- collection of demographic information about respondents (age, gender, and level of accounting experience).

As explained, 559 questionnaires were distributed (this being the total number of UK resident members of ACIE in February 2006) and the response was 240 (42.9%).

5.2 Characteristics of Respondents

On the question of levels of accounting experience, the respondents categorised themselves as shown in the chart.

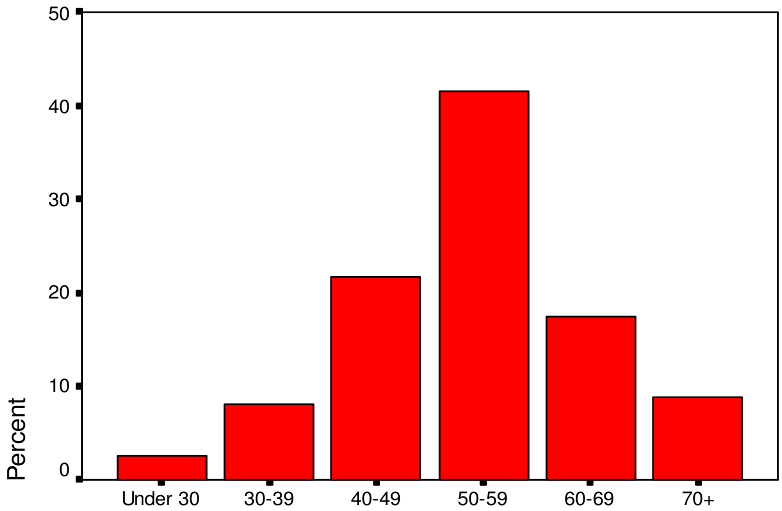


Some 59% of respondents thus classified themselves as “professional accountants”, but other categories of respondents were also well represented, including 24% who selected the most appropriate self-description as being "an experienced independent examiner, but not a professional accountant".

The split by gender identified 70% of respondents as male and 30% female[19].

A cross-tabulation between gender and accounting experience showed the profile of accounting experience (in terms of the proportion of respondents allocating themselves to each of the four categories above) was very similar for male and female respondents.

The age profile is as indicated by the following chart.



Clearly there is a domination of middle-aged respondents, but IEs of all ages are represented. However, a breakdown by age and gender indicates a slightly younger average age for female respondents, with women representing the majority of respondents in the first three age bands.

5.3 Numbers of Sets of Charity Accounts Dealt With

The responses to question 1, asking how many sets of charity accounts each participant typically dealt are as shown in the table.

	Total charity accounts prepared	**Total charity accounts IE or audited**	**Accounts on R&P basis prepared**	**Accounts on R&P basis IE or audited**	**Accounts on SORP basis prepared**	**Accounts on SORP basis IE or audited**
Mean	7.9	7.9	2.7	3.1	5.1	4.9
Median	3	3	1	1	1	1
Minimum	0	0	0	0	0	0
Maximum	110	120	97	107	75	70

These figures show huge variations – a small number of respondents dealt with no charity accounts at all – but one respondent was independently examining or auditing 120 sets of charity accounts per year. The average was around 8 sets of accounts per respondent, but

[19] All figures are given to the nearest 1% and the baseline is the number of valid responses to the question concerned.

this was skewed by a few giving very large figures – the median was 3 sets of accounts per year.

However, what is highly significant for the purposes of this study is that there is good experience amongst respondents of both regimes. The average respondent examined (or audited) some 3.1 sets of accounts per year on an R&P basis and 4.9 sets on the SORP/accruals basis. So, whilst there is slightly more experience of charities using the SORP basis, the respondents' opinions draw on extensive experience of both approaches.

Across the whole population, this means that the survey gives experience drawn from nearly 1900 sets of charity accounts independently examined (or audited) of which 39% were on the R&P basis and 61% on the accruals/SORP basis. Whilst a 50/50 split was never expected in response to this question, this indicates very substantial responses from both sides of the debate.

Taking the figures for accounts prepared (as opposed to accounts examined or audited) gives slightly fewer on the R&P basis (2.7 per respondent) indicating, as suggested in chapter 3, that a proportion of charities using the R&P basis are able to prepare their own accounts, and only require their IE to perform the independent examination. However, for SORP accounts, the converse applies, with respondents involved on average with 5.1 sets of accounts prepared against 4.9 examined or audited (some of these could, of course, be due to respondents preparing accounts for their own organisation, which they would naturally be ineligible to scrutinise).

5.4 Views on the Statements Presented

As explained, participants were invited to respond to each of 11 statements in question 2 (a) to (k) on a Likert scale. See Appendix B for the actual statements and prompts to respondents.

Responses were scored on a scale from 1 (strongly disagree) to 5 (strongly agree) so a neutral response was scored 3. Where the mean response is therefore in excess of 3, participants on balance tended to support the statement; where the mean response is below 3, participants tended to reject the statement.

As normal in studies of the kind, some issues were presented in similar statements worded both positively and negatively in order to assess the consistency of responses. No unusual correlations were found as a result which suggests that most respondents understood the statements.

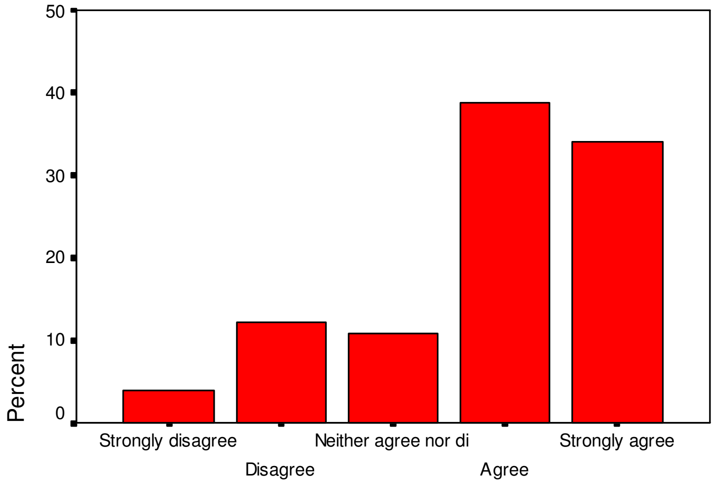
For each of the 11 statements, a figure is given for the mean response (on the 1-5 scale) and a bar chart showing the percentage of respondents selecting each option. The bar chart is helpful in providing a visual indication of the level of agreement.

The figures and charts below exclude those not responding or not giving an opinion to a statement – however this never exceed 26 (for statement (h)). Hence, in each case the opinions below are based on at least 214 valid responses.

It will be seen that the general tendency was towards agreement with each of the comments (a)-(h) and disagreement with comments (i)-(k). However, in no case was there a totally clear view one way or the other: every question had answers right across the range from "strongly agree" to "strongly disagree".

5.4.1 Q2(a) "R&P accounts are easier to understand by those who are not accountants"

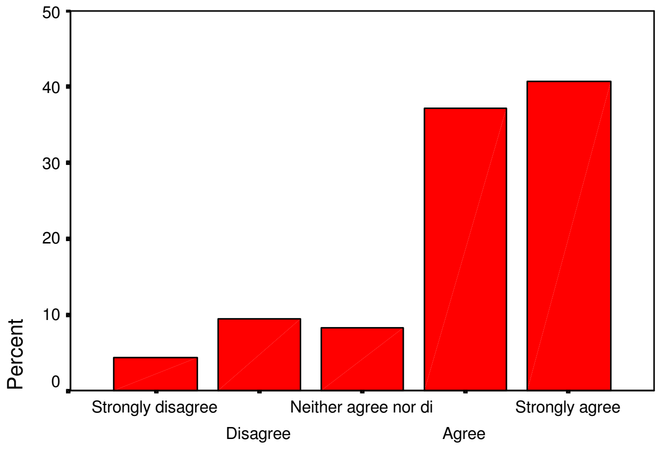
Mean: 3.87



This assumption that R&P accounts are in some sense easier for non-accountants is fundamental to the whole basis of the R&P regime. Although there was clear agreement with this statement it is interesting to note that the agreement was far from universal with more than 20% of respondents either neutral or disagreeing.

5.4.2 Q2(b) "Starting from the typical books of a charity treasurer or bookkeeper, it is a good deal quicker to prepare R&P accounts than to do a full set of accruals accounts in SORP format"

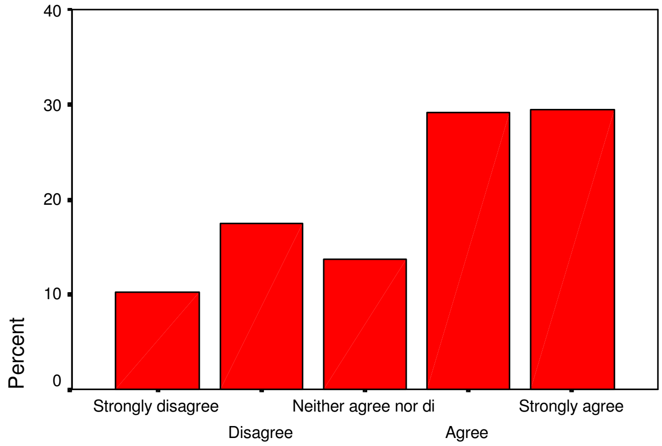
Mean: 4.00



There was clearly strong agreement with this statement – even stronger than for the previous statement regarding ease of understanding. So it is clear that most respondents clearly feel R&P accounts are less work to prepare.

5.4.3 Q2(c) "The trouble with R&P accounts is that even for smaller organisations, they rarely give a proper view of the charity's financial position"

Mean: 3.50

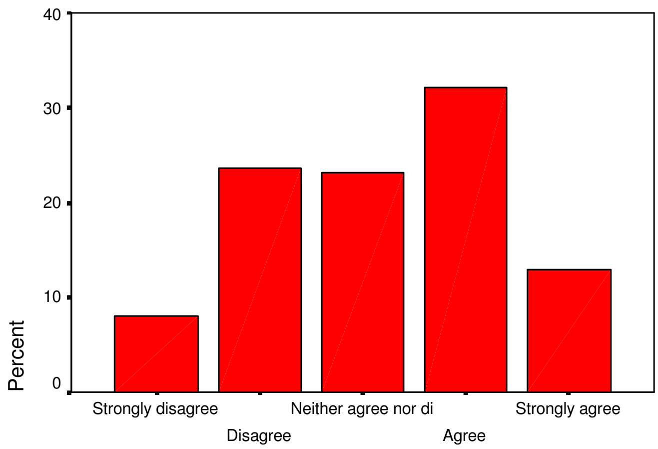


Responses to this statement were much more varied. This statement sees R&P accounts negatively ("they rarely give a proper view of the charity's financial position") and the majority *agreed* with this limitation of R&P accounts.

But it would appear significant that nearly 30% of respondents *disagreed* with the statement – so these respondents, by implication, felt R&P accounts could give a proper view of a charity's financial position.

5.4.4 Q2(d) "Funders and donors often misinterpret accruals accounts – for example by forgetting that the fund balances include fixed assets – R&P has less risk of misunderstanding"

Mean: 3.18

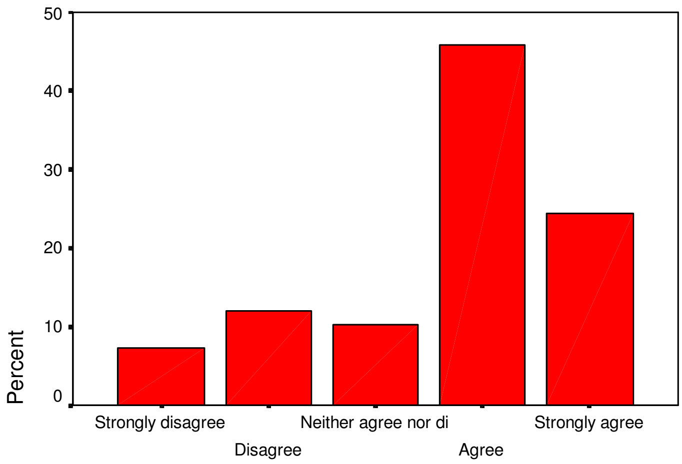


This statement was included as a result of the author's experience in leading workshops on charity accounting. For example, participants in workshops often reported that they found it difficult to understand that with accruals accounts a fund which had been fully spent on the purchase of a fixed asset does not have a balance of nil, because it still holds the value of the asset purchased. Some participants also reported curious questions from funders on these lines, suggesting funders were having difficulty reading accruals accounts.

On balance, there was a general tendency to *agree* that accruals accounts were often misinterpreted this way by funders and donors. But there is a wide range of views on this issue, with all responses from "strongly disagree" to "strongly agree" being well represented.

5.4.5 Q2(e) "There is a real danger with R&P accounts that, with few rules on what's required, a charity may omit crucial details which ought to be shown in the notes to the accounts"

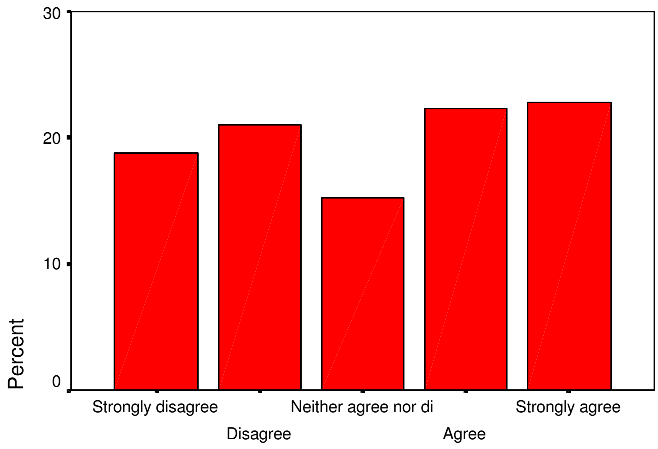
Mean: 3.68



This concern, highlighted in chapter 2, on the lack of clear rules on R&P accounts, was well shared, with over 70% of respondents agreeing with the statement. Nevertheless, around 20% of respondents seemed quite definite that this uncertainty was *not* a problem.

5.4.6 Q2(f) "If I am acting as IE to a charity where the trustees have limited accounting experience, I would rather they presented their published accounts on an R&P basis"

Mean: 3.09

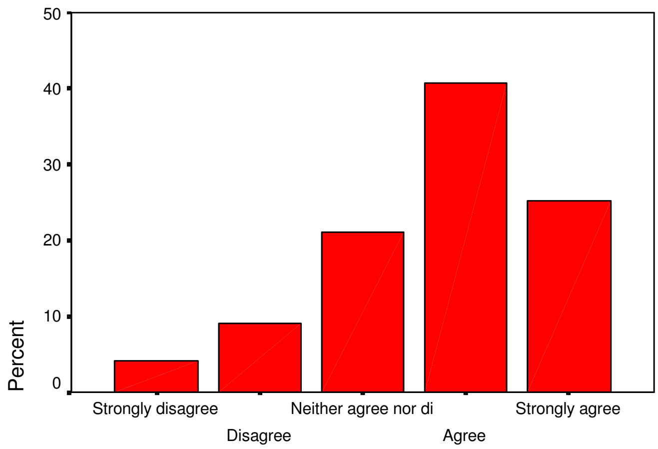


This statement sought to explore whether or not respondents saw SORP accounts as potentially dangerous (in effort, complexity, or understanding) and whether they would encourage trustees with limited accounting experience to stick to the R&P basis.

As indicated by the mean extremely close to 3 and by the bar chart, respondents were almost equally spread on this issue – though most clearly agreed or disagreed, rather than selecting the neutral option. A small majority preferred the R&P basis where trustees have limited accounting experience – but those who disagreed presumably felt the SORP format was equally suitable (or even helpful) in such cases.

5.4.7 Q2(g) "The statement of assets and liabilities (SOAL) is crucial in understanding charity accounts on an R&P basis"

Mean: 3.74

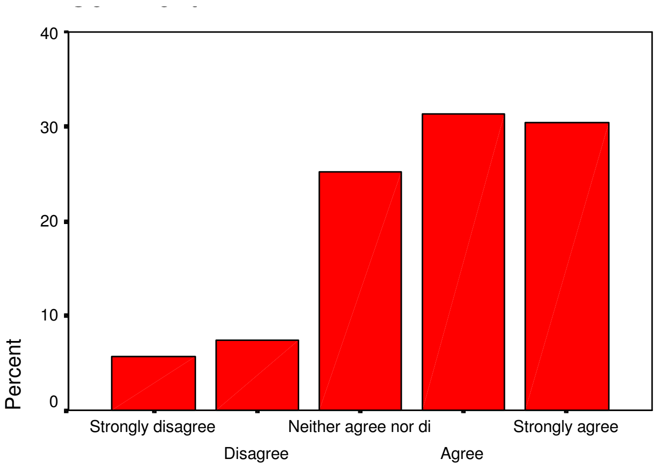


Much of the anecdotal criticism of R&P accounts seems, in the author's experience, to rest on the lack of a balance sheet, so it was felt worth assessing how strongly respondents felt about the need to the SOAL. One of the commonest errors with charities preparing R&P accounts is to include the R&P account, and possibly a reconciliation of fund balances to cash at bank, but without anything clearly labelled as a "statement of assets and liabilities" – and hence no means for the reader to know whether the charity has any assets or liabilities beyond the cash balance shown.

Most participants tended to agree with this statement – which suggests, at least amongst ACIE members, that the place of the SOAL in R&P accounts is clearly accepted.

5.4.8 Q2(h) "Most funders of voluntary organisations prefer to see accounts in SORP format"

Mean: 3.73

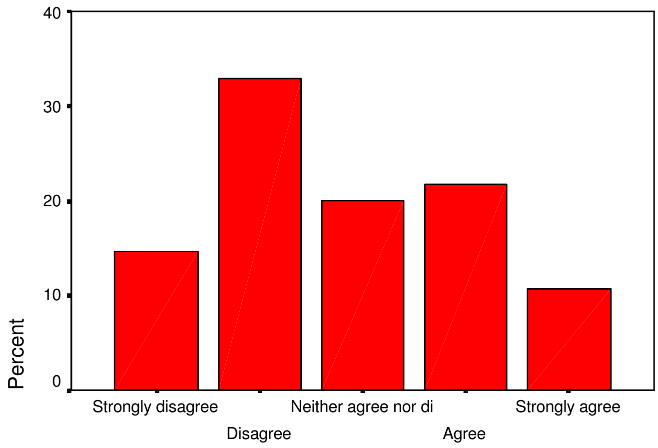


This is a statement the author has heard on various occasions, and it seems that there is considerable agreement from respondents. The extent to which funders really do prefer to see accounts in SORP format will be considered in the next chapter, but certainly this is a strong perception amongst independent examiners.

On the basis of this answer, it seems likely that IEs will, at least to some extent, steer their charity clients towards producing account on the accruals/SORP basis where funders are seen as an important user of the charity's accounts.

5.4.9 Q2(i) "It is hard for independent examiners to report on R&P accounts because there are few rules about presentation, so it is difficult to decide when the accounts are poor enough to need a qualified IE report"

Mean: 2.81

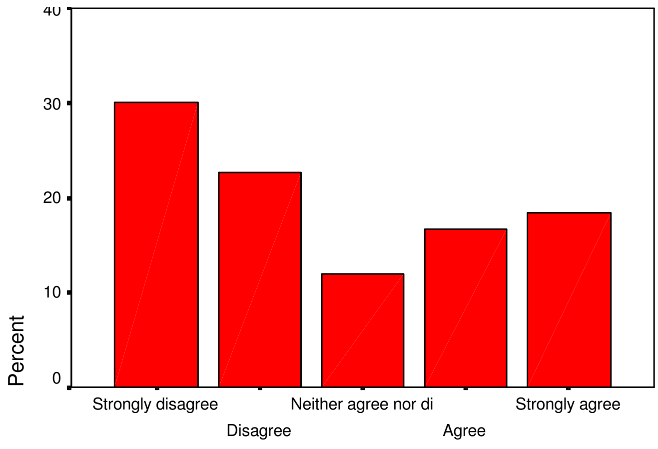


This statement reflected the difficulty identified in chapter 3 that it can be hard for IEs to judge whether or not a qualified report is needed with R&P accounts, due to the lack of clear rules.

On balance, respondents *disagreed* with this statement – most did not perceive this to be a problem – so it would seem that in general IEs are reasonably comfortable with the R&P basis, and so not feel it presents special problems for IEs. However, over 30% agreed with the statement, so it is evidently an issue of concern to many, if not the majority.

5.4.10 Q2(j) "I think all charities should have to do SORP accounts, whatever their size"

Mean: 2.71

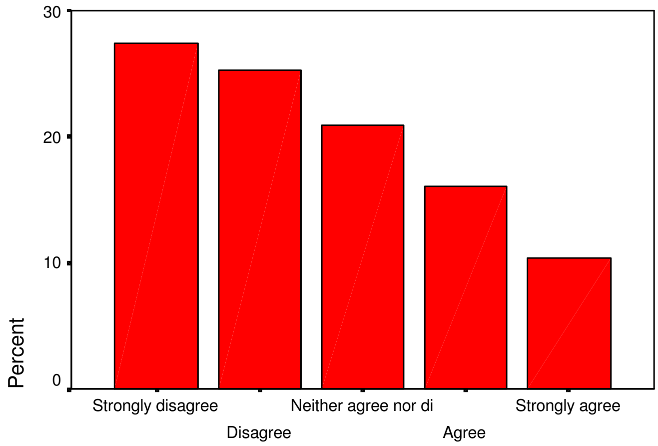


This statement is also one which the author has heard frequently expressed in discussions, but it is clear that the majority of ACIE members do *not* believe that SORP accounts should be forced on all. In fact, no less than 30% *strongly disagreed* with this statement – showing very clear support for the R&P basis.

However, there was a substantial minority – more than 35% – who clearly rejected the R&P basis, and wanted the SORP regime imposed on all charities.

5.4.11 *Q2(k) "I agree cash is king. With R&P accounts you can see exactly what has been going on – accruals accounts allow too much scope for manipulation."*

Mean: 2.57



This statement was, in part, the converse of the preceding statement, allowing respondents to express agreement for the R&P regime being fundamentally clearer than the SORP format. In particular, following the concerns about the manipulation of accounts of public companies, it was decided to test whether respondents felt R&P accounts were in any sense more reliable.

A clear majority *disagreed* with this statement – on balance respondents did not see SORP accounts as providing excessive scope for manipulation. So there is no demand for abandonment of the SORP regime and a return to cash-based financial statements as the norm. However, a minority of around 25% expressed some agreement with the statement – so perhaps for these respondents, R&P accounts are not just simpler but actually give a more realistic view.

5.5 Summary

The data presented in this chapter shows a rich wealth of material even though it only considers the statistical issues (narrative comments from the survey are considered in chapter 7). The large number of ACIE members who responded to this study have substantially experience of both the R&P basis and the accruals basis for charity accounts.

Many of them clearly have strong opinions about the relative merits of the two regimes – but there is no sense of independent examiners lining up strongly behind one regime or the other. Clearly there are certain respondents who would prefer all charities to have to use the SORP format, regardless of size, and there are others who see the R&P basis, with the factual reporting of cash and out, as being more effective. But in neither case did a majority of respondents argue these positions – the majority of respondents appear to see the merits of both formats.

There was strong agreement that R&P accounts are generally simpler to prepare, and most also felt they were easier to understand by those with limited accounting experience. But equally there was a strong belief that funders prefer the SORP format. There was an almost exactly equal division of opinion on *Q2(f) "If I am acting as IE to a charity where the trustees* *have limited accounting experience, I would rather they presented their published accounts on an R&P basis"* – with many respondents clearly preferring the SORP basis even for charities where the trustees have limited experience.

The implications of this will be explored further in chapter 7. In the meantime, chapter 6 reports the findings of a study exploring the same issues with funders.

6. The Views of Funders

6.1 The Audience and the Issues Explored

As well as seeking the views of those involved in preparing and scrutinising charity accounts (as reported in the last chapter) it was felt essential – as explained in chapter 4 – for this study also to seek opinions from those who are external to a particular charity, but who are *users* of the published annual accounts of smaller charities.

It was felt that the most obvious class of external users would be funders or donors. However, it is clear that only a small minority of individual donors ever look at a charity's accounts before donating, whereas institutional funders routinely ask for a copy of the annual report and accounts from organisations applying for funds.

Within the range of institutional funders of voluntary organisations, there are several possible categories (e.g. public sector bodies, lottery distributors, grant-making trusts). Within the resources available for this study it was decided to focus on one category – grant-making charitable trusts in membership of the Association of Charitable Foundations (ACF). As mentioned in chapter 4, the fact that ACF members are themselves charities meant that they would perhaps have a closer affinity with the requirements of charity law than (say) a local authority grant-maker – in fact a number of grant-making charities *only* give grants to other charities. ACF kindly agreed to circulate a questionnaire to its members.

The two-page questionnaire used is reproduced in Appendix B. It was deliberately kept as similar as possible to the questionnaire used with ACIE members (as reported in the last chapter) to permit comparisons of views – but adapted to make the content applicable to charitable grant-makers. It comprised

- a short section gathering quantitative data about respondents in terms of whether or not they made grants to smaller charities and the extent to which they required accounts to be submitted
- a series of 11 statements regarding R&P accounts (or conversely, regarding accruals/SORP accounts) about which respondents were invited to express their opinions on a five point Likert scale (from "strongly disagree" to "strongly agree") – these were essentially the same as used with ACIE members, but reworded to the perspective of a user of the accounts[20]
- space for respondents to add additional narrative comments (these are considered in chapter 7)
- collection of demographic information about respondents (role in the grant-maker concerned, and personal level of experience of charity accounts).

As explained, 353 questionnaires were distributed with an ACF mailing in November 2007, with a reply-paid enveloped enclosed. The response was 24 which is only 6.8% of the initial

[20] For example, statement 2(i) on the ACIE survey was *"It is hard for independent examiners to report on R&P accounts because there are few rules about presentation, so it is difficult to decide when the accounts are poor enough to need a qualified IE report*". For the ACF study it read: *"We would have less confidence that an independent examiner's report on R&P accounts would highlight real problems."*

sample – but as indicated below, 23 out of these 24 indicated that they do make grants to charities under £100,000. This was a much higher proportion than expected, bearing in mind that many ACF members specialise in areas of grant-making where charities under £100,000 would not normally be recipients. Furthermore, *all* of these 23 (100%) said that they require applicants to submit previous years accounts – either at the time of initial grant application or as part of post-grant monitoring. This was a higher proportion than expected based on the author's experience of discussions with grant-makers.

Furthermore, an extraordinary 100% of respondents provided additional narrative information in question 1(e) explaining how accounts were used and 50% added further narrative comments in question 3. Many of these comments were quite detailed. This suggests a high level of interest from those who chose to respond.

Overall, therefore, the number of responses may well be a significant proportion of those ACF member who both (a) make grants to charities under £100,000 income and (b) ask such charities to submit their accounts. But it is impossible to estimate this accurately.

Care should therefore be taken in interpreting the statistical information reported in this chapter. Given the relatively small number of responses, no bar charts are provided, and where percentages are given they are stated only to the nearest 5%. However, in terms of revealing the views of funders who are *seriously interested* in the accounts of small charities applying for funds, these 24 responses provide a great deal of useful material.

6.2 Characteristics of Respondents

All of respondents clearly had specific roles in grant-making charitable trusts – the breakdown of roles given in question 4 was:

- 4 trustees (including 2 treasurers)
- 8 chief executives/managers/clerk to trustees/trust secretary
- 5 directors (it is not quite clear whether the term was used in the sense of director/chief executive or director/trustee of a charitable company, but the former seems more likely)
- 2 grants managers/grants advisors
- 2 secretaries/administrators
- 2 charity correspondents (no further identification of role)
- 1 grant-making charity but role not specified

Total: 24

In terms of accounting experience, respondents categorised themselves as:

- 4 professional accountants
- 8 non-accountants but with experience of preparing charity accounts
- 11 considered themselves "fairly experienced" in *reading* charity accounts but not the preparation
- 1 had little experience of charity accounts

Total: 24

The majority of respondents therefore were *not* professional accountants, and would appear to be well representative of those who *use* charity accounts (in some cases perhaps also with involvement in preparing the accounts for the grant-making charities they administer).

6.3 Grant-Making and Use of Charity Accounts

Twenty-three out of the 24 respondents indicated that their trust or foundation does make grants to charities under £100,000 income. As indicated above, this is felt to be an unusually high response, and probably suggests that those who would have answered “no” to this question chose not to return the questionnaire.

The one respondent who answered “no” to this question has been eliminated from the subsequent analysis on the grounds that his/her views are not directly relevant to the issue being studied. All subsequent figures are therefore based on the 23 respondents whose trusts do make grants to small charities (the “relevant grant-makers”).

Of the 23 relevant grant-makers, 21 (90%) require *grant applicants* to submit their previous years accounts, and 9 (40%) require *grant recipients* to submit their accounts subsequently after grants have been made. (All 23 answered “yes” to at least one of these possibilities, so 100% used the accounts in some way, although some indicated that they may obtain applicants’ accounts from the Charity Commission web site, rather than requesting them directly.)

All 23 respondents (100%) provided some narrative comments on *how* applicants’ accounts are used in grant-making. Key aspects mentioned include the following (responses total more than 23 due to respondents who made more than one point):

- an overall check on the financial health, cashflows, financial viability (6 cases)
- assessment of governance, financial controls, skills in money management (4 responses)
- to consider specific information in the accounts (9 cases) – “reserves” were mentioned most frequently, but also “other sources of funding”, patterns of past expenditure, relating the grant requested to previous levels of income, “unusual items”, etc.
- looking at the independent scrutiny the accounts had received (3 cases) and sign off by trustees (1 case)
- 2 answers made clear that the accounts are extensively reviewed and summary information presented to trustees but did not give details of the process.

6.4 Views on the Statements Provided

As explained, respondents were offered 11 statements, as listed in appendix B, and invited to express an opinion on each statement using a Likert scale from 1 (strongly disagree) to 5 (strongly agree).

The analysis is based on the 23 relevant grant-makers who responded, but most statements had one or two respondents selecting “not applicable/no opinion” so mean scores are generally based on 21 or 22 responses (and because of the small numbers the means are computed to just one decimal place).

6.4.1 Q2(a) "R&P accounts are easier to understand by those who are not accountants."

Mean: 3.8

There is broad agreement with this proposition (as with the ACIE members) which is fundamental to allowing smaller charities to use the R&P basis. However, six responses were neutral, and one person strongly disagreed with the statement.

6.4.2 Q2(b) "I feel it is less work for smaller charities to produce R&P accounts than to do a full set of accruals accounts in SORP format - even if their accountant or independent examiner handles most of the preparation."

Mean: 3.9

There is strong support for the fact that R&P accounts are simpler to prepare – and, as with ACIE members, the support for this is even strong than for Q2(a).

6.4.3 Q2(c) "The trouble with R&P accounts is that even for smaller organisations, they rarely give a proper view of the charity's financial position."

Mean: 3.6

As in the first study, this statement was worded so that those agreeing with the statement were agreeing with a negative view of R&P accounts. The mean score from ACIE members was 3.50 – but this might have been expected from respondents who included many professional accountants. It is therefore interesting that even though the vast majority of respondents to the funders' survey are not professional accountants, they too agree with this statement – if anything slightly more strongly than the ACIE members (although no significance can be placed on a small variations in the score given the limited responses to this second survey).

Nevertheless, four respondents (20%) *disagreed* with the statement – and thus, by implication, felt that R&P accounts could give a proper view and five respondents (25%) were neutral. But those taking this view were clearly a minority.

6.4.4 Q2(d) "It is easy to misinterpret accruals accounts - for example by forgetting that the fund balances include fixed assets - R&P has less risk of misunderstanding."

Mean: 2.4

As mentioned in the last chapter, this is a criticism which had sometimes been raised by charities discussing funders who had misunderstood their accounts. However, it was perhaps unlikely that funders would agree with their own misunderstandings which is born out by this answer showing a net *disagreement* with this statement. (This is quite a difference from the 3.18 score – a net agreement – from the ACIE members.)

Even so, five respondents (25%) agreed with the statement, and it must be noted that the respondents to this funders survey do appear to have an unusually high interest in accounts – so for them, the risk of misunderstanding fund balances was less likely than for funders in general.

6.4.5 *Q2(e) "There is a real danger with R&P accounts that, with few rules on what's required, a charity may omit crucial details which ought to be shown in a note to the accounts."*

Mean 4.0

This statement showed a high level of agreement, with no one at all disagreeing, and a mean score even higher than the 3.68 result from the ACIE survey. So it would appear that funders are quite concerned at important information being potentially omitted from R&P accounts.

6.4.6 *Q2(f) "As a funder, if we are dealing with a charity where the trustees have limited accounting experience, I would rather they presented their published accounts on an R&P basis."*

Mean 3.2

Respondents were much more balanced on this issue, with a slight tendency towards agreement, but eight respondents (35%) selected the neutral response ("neither agree nor disagree" and five (25%) disagreed. But it would appear that despite reservations expressed in the previous questions, most funders just about agree that it makes sense to produce R&P accounts where the trustees have limited accounting experience.

6.4.7 *Q2(g) "The statement of assets and liabilities (SOAL) is crucial in understanding charity accounts on an R&P basis."*

Mean 4.2

As noted in the last chapter, the role of the SOAL in R&P accounts seems to be widely misunderstood – so the views of funders was important (assuming they understood the SOAL enough to comment, but only one respondent selected "NA").

This statement produced the highest degree of agreement (and no one disagreeing). In fact, given the importance which the funders placed on looking at reserves, it is unsurprising that with R&P accounts, the SOAL was felt to be very important.

So – where R&P accounts are used – the SOAL cannot be seen a being in any sense optional: it is clearly seen to be vital by funders.

6.4.8 *Q2(h) "Most funders of voluntary organisations prefer to see accounts in SORP format."*

Mean 3.7

The views of funders themselves on this issue (as opposed to the perceptions of funders as felt by independent examiners, reported in the last chapter) was critical to the study.

Overall, there is a high level agreement with the view that funders in general (though not necessarily the respondent) prefer to see SORP format accounts. The mean score is almost identical to the perceived views of funders on this issue (3.73) as expressed by ACIE members.

6.4.9 Q2(i) "We would have less confidence that an independent examiner's report on R&P accounts would highlight real problems."

Mean 3.4

This was quite a difficult issue for funders to comment on, but only one person selected "NA". The score therefore suggests quite a strong degree of concern from funders that inadequate R&P accounts could get through an independent examiner without leading to a qualified report.

This is a converse result to the views of ACIE members who gave a mean score of 2.81 (net disagreement) to this question – although even amongst these, 30% agreed with the statement.

6.4.10 Q2(j) "I think all charities should have to do SORP accounts, whatever their size."

Mean 2.7

Overall there is clear disagreement with this statement – most grant-makers clearly accept that R&P accounts have a place for smaller charities. The score was almost identical to that from ACIE members. This was the one statement where all 23 respondents expressed a clear a view.

However, as with the ACIE respondents, there was a wide range of views, with 10 respondents (45%) agreeing with the statement two (10%) neutral, and 11 (50%) disagreeing. The fact that the mean score came out well below the neutral 3.0 was mainly a result of eight respondents who *strongly* disagreed with the statement as opposed to just three who *strongly* agreed.

But those applying to grant-making trusts need to bear in mind that nearly half (45%) would appear to prefer SORP accounts even from the smallest charities.

6.4.11 Q2(k) "I agree that cash is king. With R&P accounts you can see exactly what has been going on - accruals accounts allow too much scope for manipulation."

Mean 2.8

On balance, respondents disagreed with this statement (though not as strongly as the independent examiners who gave a mean score of just 2.57). There were good numbers both for and against this statement, but the final score was influenced by two respondents who strongly disagreed.

So, overall, most grant-makers were unwilling to agree with a statement that R&P accounts were superior, which ties up with the general support for SORP presentation expressed in previous questions.

6.5 Summary

Even from a modest sample of 23 relevant responses, it is clear that grant-makers who support smaller charities make considerable use of the accounts they receive, and have clear views on the presentation. Many extract a great deal of information from the accounts of applicants and use it in their grant-making decisions; others use the information to monitor grants made (and, presumably, in deciding whether to continue multi-year grants).

Nearly all the respondents have clear views on the accruals versus R&P debate for smaller charities. On balance, most accept that R&P accounts are simpler for small charities and most (though not all) accept that R&P accounts have a place for small charities seeking funding. Where R&P accounts are provided, funders certainly want to see the statement of assets and liabilities (SOAL). But they tend to agree quite strongly with the statement that "most funders prefer to see accounts in SORP format" and many have considerable concerns about R&P accounts, particularly as to whether or not independent examiners will be in a position to highlight problems (several respondents mentioned under Q1 that they take a particular interest in the scrutiny report).

There are a few respondents who were strongly supportive of the R&P regime – but for the most part it seems R&P accounts are tolerated rather then welcomed by funders – and it is worth noting that a significant minority (45%) would like see all charities required to present their accounts in SORP format.

7. The Role of Receipts and Payments Accounts: Further Comments and Assessment

7.1 Introduction

The two surveys reported in chapters 5 and 6 give some wide ranging views on the merits of R&P accounts and accruals/SORP accounts for charities. They show that both amongst those preparing and examining charity accounts, and amongst grant-makers using charity accounts to make funding decisions, there is broad spectrum of opinion.

The value of the surveys is in giving some quantitative information on the strength of feeling on the key debates. This chapter seeks to explore the issues further by taking qualitative findings into account.

(a) It explores some of narrative comments in the two surveys – especially Q3 which asked for “Your Own Views” with the questions:

- *Do you have any other comments on the advantages or disadvantages of R&P accounts?* (in the survey of ACIE members) and
- *Do you have any other comments on the advantages or disadvantages of R&P accounts in terms of smaller organisations applying to you for funding?* (in the grant-makers survey circulated through ACF).

(b) It also takes into account the views of regulators, and of charities themselves, based on a number of informal interviews and workshop sessions, as described in chapter 4.

7.2 Narrative Survey Comments on R&P versus Accruals

A substantial proportion of respondents to both surveys chose to give additional narrative comments under Q3 on their own views of the advantages and disadvantages of R&P accounts for small charities. Comments were given by 35% of respondents to the ACIE survey (these are identified as “IE” below) and 50% of respondents to the ACF survey (identified as “Funder”) below. In both surveys, most of the comments were carefully argued – the majority amounted to at least a couple of sentences, but in a few cases respondents attached up to a page of additional comment.

Comments from either survey from individuals who described themselves as “professional accountants” are identified as such; all others are classified as “non-accountants”. However, many of the “non-accountants” have considerable accounting experience, especially if acting as independent examiners, or if involved in financial assessments of grant applicants.

The comments reflect the diversity of views from the statistical analysis reported in chapters 5 and 6 – with some strongly in favour of R&P accounting for smaller charities and some strongly opposed. However, the comments shed additional light on the *reasons* behind the views expressed by the statements offered in the surveys – this section seeks to reflect the range of comments made.

7.2.1 *The Mid-Way Position*

It is perhaps first helpful to consider the views of those who take a mid-way position - those who can see arguments for both formats of charity accounts.

> *I think the type of accounts required depends ultimately on the type of charity/organisation. One size does not fit all!* [IE, non-accountant].
>
> *R&P accounts are useful for small organisations as SORP accounts are more intricate to prepare and submit. [But] SORP accounts give a more rounded picture of the financial health and governance of the organisation.* [Funder, non-accountant – some other funders expressed similar views]
>
> *Although I believe SORP accounts do give a better overall picture, I am very much in favour of allowing R&P accounts to continue for smaller charities ….* [IE, non-accountant]
>
> *We are not bothered. We expect what is appropriate for the size of organisation.* [Funder, non-accountant]
>
> *Trustees [of grant-making charities] should accept R&P accounts – but scrutinise them carefully.* [Funder, professional accountant]
>
> *R&P accounts for smaller charities are adequate when balance sheet items such as fixed assets, accruals and prepayments are not material – otherwise accruals accounts are preferable.* [IE, professional accountant]
>
> *Those who prepare accounts want to show a true and fair view – hence SORP accounts would be most appropriate but are much too complicated. For small charities who can only understand R&P [they can] add notes for clarity.* [IE, professional accountant]
>
> *If somebody sets out to deceive, it doesn't matter what the format – detecting the deception is difficult.* [IE, non accountant]
>
> *The essential criterion [in choosing the format] is: what decision are the users going to make reading the accounts?* [IE, professional accountant]
>
> *R&P accounts are open to misinterpretation, as are full SOFA/Balance Sheet accounts. People do not always pick up on restricted funds or assets – believing that any cash can be spent any way.* [IE, professional accountant]

7.2.2 *Other Issues*

Several others commented on the importance of showing restricted funds properly – but *either basis* – SORP or R&P – should enable restricted funds to be clearly identified, even if only the minimum requirements are followed, so this is not really an argument for one approach rather than the other.

Some of the funders felt that the more important issue was not the form of accounts, but the scrutiny:

The main disadvantage [of R&P] is not in the style of accounts, but the requirement for independent examination/audit. Independent examination should be a minimum requirement – and the examiner named. [Funder, non-accountant – similar (if less explicit) comments were also made by others]

The sentiments are clear, although is not certain whether this respondent was commenting on the need for independent examination even for charities under £10,000 income, or was assuming R&P accounts never needed independent examination. If the latter, this was a misunderstanding – all charities over £10,000 income now require at least an independent examination, and the examiner's name and address must always be given. However, it is often the case that accounts of smaller charities submitted to funders fail to include a proper IE report, even when this is legally required.

7.2.3 Preferences for SORP

Others were very clear that SORP format was preferred – in some cases arguing that this was essentially easier for all concerned:

I recommend accruals basis for all charities, as it gives a good view of the charity's financial performance. [IE, professional accountant]

SORP (accruals) accounts are now so well established as standard that many funders and trustees are fully "at home" with them. [IE, professional accountant].

A balance sheet is easier to understand than a statement of assets and liabilities [IE, professional accountant]

The fact is that many charity accountants do not follow the rules as it is. R&P will simply make matters worse. [Funder, non-accountant]

The only R&P accounts I have seen have been very confusing and difficult to understand – they give a misleading picture. [IE, professional accountant – others commented similarly]

I think R&P accounts tend to be misleading as to the true financial position of the charity is not always clear due to lack of supporting information. [IE, professional accountant]

Other respondents went further, arguing fundamentally for the SORP/accruals regime, in some cases with an outright rejection of the R&P basis:

R&P accounts should not be encouraged. [IE, professional accountant]

Accruals accounts help to give a fuller picture of the organisation. … When making small grants it is not always cost effective [for us] to visit and therefore the accounts become even more important in the decision making process. I would prefer that all charities were required to prepare accruals accounts. [Funder, non-accountant]

R&P accounts are often prepared in so-called 'balance sheets' with total appearing on both sides, but no visible totals for income or expenditure. If I have to do the calculations to discover how their bank balance relates to that year's payments [to assess the level of reserves] how does the management committee deal with it? [Funder, non-accountant]

Consistency is king – there is no way of comparing like for like if organisations do not follow SORP format. [IE, non-accountant]

R&P accounts are a nonsense from an accounting point of view, in that they are not double entry. [IE, professional accountant]

R&P "accounts" are not real accounts like accruals accounts with a balance sheet and notes. They are just bookkeeping. …. I always insist, if I am to be involved, that I will only work with accruals accounts. …. One of the biggest problems I encounter at the small level is that of uncleared cheques. … I find that once I've cracked the reconciled cash book, other accruals are easy. [IE, professional accountant]

R&P is the basic and lazy way of accounting. It encourages incompetence in voluntary finance workers. … To avoid confusion even small charities must use SORP. We need uniformity. [IE, professional accountant]

R&P accounts are a rogue's charter and I have seen them used for all kinds of spurious purposes. [IE, professional accountant]

7.2.4 Problems with the R&P Framework and the SOAL

Some respondents implicitly agreed that the lack of a clear framework for R&P accounts causes problems:

The main disadvantage is that people with some experience of accounts, but no experience of charities, see "R&P" and think they know what is required. [IE, professional accountant]

It would help if R&P accounts had to explain factors that might mislead e.g. early receipt of a grant for the next year period. [IE, non-accountant]

There should be more guidance on what good R&P financial statements should contain and look like. [IE, professional accountant]

R&P accounts take no account of monies owed or owing. [Funder, non-accountant]

Several others commented that significant debtors or creditors could lead to R&P accounts giving a distorted view – in fact one respondent mentioned a charity doing R&P accounts which had failed to account for a £500K land transaction. However, only a few people commented specifically on the SOAL with R&P accounts – if this is properly produced, even R&P accounts should properly disclose material debtors and creditors. So it may be that even some professional accountants working with charities, or funders receiving accounts from applicants, have not appreciated the need for a SOAL with R&P accounts. Nevertheless, one IE said:

There is as much difficulty explaining the SOAL to non-accountants as there is explaining accruals … [IE, professional accountant]

Another commented:

A simple set of outlines for R&P would help no end. SOAL is a poor option and grossly misunderstood. [IE, non-accountant]

– though it is hard to see how the SOAL could be replaced without a change in the law, given that R&P accounts in E&W must include a statement of assets and liabilities – whatever is understood by that term. But the SOAL certainly presents difficulties:

> *I have commented previously on the very limited value of the SOAL. … I see myriads of poor accounts from charities applying for [our services] – in 90% of R&P cases I need further clarification.* [IE, professional accountant – also as user of charity accounts as described.]

> *Trustees, funders and donors understand R&P accounts … [but] they sometimes struggle with the SOAL as they expect there to be something which balances to the fund totals …* [IE, professional accountant – others also commented on difficulties with the SOAL because it does not self-balance.]

7.2.5 The Role of the Independent Examiner with R&P

Several respondents felt that if independent examiners were doing their job properly, R&P accounts should not have significant limitations. Adding to some of the statements in Q2 regarding issues such as the possible lack of notes in R&P accounts, comments included:

> *Is it not the role of the examiner to eliminate such discrepancies?* [IE, non-accountant]

> *The IE should help on this front by examining records past year end, and stating what should be included in the notes to the accounts – if it is not there already.* [IE, professional accountant]

7.2.6 The Starting Point for Accruals

Although the two surveys in this study pre-dated the recent consultation on thresholds in the Charities Acts (Cabinet Office/Charity Commission 2007), and no specific questions were asked on thresholds, several respondents commented on the threshold at which accruals accounts become compulsory (currently £100,000 income).

Several IEs and funders said that they felt the £100,000 income limit for R&P accounts was too high. For example:

> *Rather than increasing the Scottish limit from £25K to £100K, I would have preferred to see the limit in E&W reduced to £25K.* [IE, professional accountant]

> *I feel strongly that R&P accounts are really only appropriate for the smallest of charities, say £10K or less income.* [Funder, professional accountant]

> *All size charities should be done on an accruals basis. … I now consider that non-accountants should not be allowed to compile accounts on anything over £10K. …* [IE, professional accountant]

> *Most charities above £15K-£20K income would be better with accruals accounts.* [IE, professional accountant]

> *My view is that only the smallest charities (< £10K receipts?) should have their financial statements prepared on a R&P basis.* [IE, professional accountant]

One or two respondents were willing to accept both systems, but wanted criteria other than a simple income threshold at which accruals become compulsory:

> *R&P accounts are inadequate when accruals etc are omitted. … I believe that SORP (or a simplified version) should be applied if creditors/debtors amount to more than 5% of total income or expenditure in a year.* [IE, professional accountant]

All those who chose to comment on the R&P upper limit argued that it should be decreased. No one at all in either survey expressed a view that the £100,000 upper limit for R&P accounts should be increased.

7.2.7 Advantages of the R&P Basis

On the other hand, the simplicity and potential advantages of R&P were recognised by many respondents – including many professional accountants.

> *R&P accounts are best for small charities.* [IE, professional accountant (retired) – similar comments were made by many others.]

> *The smaller the charity, the more likely that R&P accounts will be just as, if not more, suitable.* [IE, professional accountant]

> *For most small organisations R&P accounts are perfectly adequate and simple for both committees and members to understand. … Except for large charities, I suggest keeping it simple.* [IE, professional accountant]

> *R&P accounts are far easier for non-accountants to understand. Trustees with little financial experience are more likely to show an interest in accounts that mean something to them and are not 'scary'.* [IE, professional accountant – a view supported by several others]

> *For small charities, R&P account are appropriate given (a) the small amounts of funds involved, (b) there is always someone who can understand the preparation of the accounts, (c) cost – not all charities can afford to pay accountants fees.* [IE, non-accountant]

One respondent implied that the lack of rigidity on R&P accounts (i.e. without detailed regulations on format) was a potential advantage:

> *For smaller charities, R&P accounts probably seem less daunting [with] flexibility in presentation.* [IE, non-accountant]

For several respondents, the role of volunteers dealing with charity accounts was seen to be critical to the debate:

> *Small charities are heavily dependent on volunteers, and it may be easier to get a volunteer to prepare R&P accounts.* [IE, professional accountant – view supported by many others.]

> *There is a very strong possibility that we will see a max exodus of treasurers if R&P accounts are not [accepted as] the norm for smaller charities say up to £100K at least.* [IE, non-accountant – similar views were expressed by others.]

> *Up to £100K, the accounts need to be as simple as possible … both for the treasurer (usually an enthusiastic volunteer) and the recipients.* [IE, non-accountant]

Several respondents felt that use of R&P accounts would be likely to save the charity fees – either by needing less professional time than for accruals/SORP accounts, or by enabling the accounts to be prepared and independently examined entirely by volunteers – for example:

> *Professionally, I think the cost of preparing small charity accounts should be considered at all times* [IE, professional accountant – several other professional accountants supported this view and were keen to save small charities from unnecessary fees.]

7.2.8 Technical Comments

There were also a small number of technical comments, which did not necessarily argue for or against either approach, but commented on issues such as the difficulties to be addressed when charities convert between the accruals and R&P bases in different years.

7.3 Other Views – Perceived Views of Regulators

Various attempts were made over the three years of this study to seek views from members of staff at the Charity Commission or OSCR regarding the suitability of R&P accounts versus SORP/accruals accounts in terms of the regulation of charities. In the end it was not possible to conduct any formal interviews on this basis – in every case, it seemed staff changes, pressures of work and the anticipated launch of new publications meaning there was "never a good time". However, from informal conversations and documentary sources a number of points emerged[21]:

- There is no doubt that the SORP regime is central to the CC's regulatory task, and OSCR is now taking a similar approach. The latest SORP Committee is jointly convened by the CC and OSCR, and both regulators are now putting considerable effort into supporting the SORP committee and getting the SORP right. By contrast, it seems that the time and effort put into supporting the R&P basis, at least in England and Wales, is very small. However, OSCR is placing a more equal emphasis on the two regimes, and is keen to ensure that smaller Scottish charities using the R&P basis comply with the Regulations (see Appendix A).

- In the case of a charity undergoing any kind of investigation or formal inquiry, SORP accounts are crucial – it is relatively difficult for inquiry teams when SORP accounts are unavailable. In fact, considerable effort was put into the framework for group accounts under the Charities Act 2006, so that charities cannot avoid full disclosure of their accounting arrangements by use of subsidiary companies which might only file abbreviated accounts at Companies House.

- However, regulators are very aware of the regulatory burden created by the SORP regime, and very keen to reduce the burdens on smaller charities. So on that basis, they are very happy to allow smaller charities to account on an R&P basis – and even to entertain increases in the R&P upper threshold (the CC has now agreed to support an increase in the threshold in E&W).

[21] It must be stressed that these points are the *author's perceptions* of the issues for regulators, drawing on publications and informal discussion on related issues, rather than direct views expressed.

- But there is some frustration by regulators that guidance which the CC and OSCR have produced on R&P accounts are not that widely used – even though standard templates are available which require little skill to complete. So, many small charities continue to file highly inadequate accounts.

- Nevertheless, because of the risk-based approach taken by regulators, which focuses attention on charities where significant funds are at risk, it is relatively rare for significant energy to be given to investigating charities under £100,000 income. Moreover it was recently reported that the CC has abandoned all random monitoring of charity accounts[22]. However OSCR has recently announced that it will begin more intense monitoring of charity accounts, and Scottish charities whose accounts fail to meet the legal requirements will be contacted and given 60 days to amend them[23] - but this policy was not in place at the time of this study, so it is too early to assess its impact.

So, we may conclude that in practice, as long as small charities file *something* which looks like a set of accounts, and sufficient to enable the charity to complete its Annual Return, it does not seem to make much difference in practice to regulators whether the R&P or accruals basis is used.

For charities of this size, it seems that only in the rarest cases will anyone from the CC actually read the accounts submitted. Moreover, very few charities now have to file accounts with HM Revenue and Customs. In England & Wales, therefore, it seems no longer appropriate to regard regulators as major *users* of charity accounts at least in terms of charities under £100,000 income.

In Scotland, OSCR clearly takes a greater interest in charities' accounts, but for charities of under £100,000 income appears to be equally happy with either basis.

7.4 Other Views – Charity Staff and Trustees

In the course of workshops with several hundred participants, the author has explained the two charity accounting regimes, and then sought the views of charity staff and trustees on their merits. The following points have emerged:

- Following a presentation of the SORP regime, with all the requirements of the SOFA, balance sheet and notes, which typically takes 2-3 hours, many participants are somewhat bewildered that it is then possible to explain the minimum requirement for R&P accounts in only about 10-15 minutes. It is thus quite difficult for them to make a meaningful comparison between two regimes – one so precise and one so vague. Sometimes, for example, people make the mistake of assuming that certain requirements of the accruals regime, such as the SOFA, are needed even with R&P accounts.

[22] *Commission ceases random accounts checks* (Charity Finance, Dec 2007 p6).

[23] The following announcement appeared in the June 2008 issue of *OSCR Reporter:*
"*Failing accounts* Over the last two years, OSCR has taken a pragmatic approach and where accounts have not met the required standard we have written to the charity with a qualified pass letter, highlighting the deficiencies requiring compliance in the following year. Accounts which do not include compliant receipts and payment accounts and statement of balances (R&P) or a Statement of Financial Activities and balance sheet (accrued) for accounting periods ending 31 March 2008 and later, will be returned to the charity. The charity will then have to make the necessary changes to the accounts and re-submit the accounts to OSCR within 60 days."

- However, many of those investing in training of this kind are from charities over £100,000 income, or, even from those below this, are often from small charitable companies where the option of R&P does not apply. This is even the case where the workshops have been offered to participants free of charge through local infrastructure bodies – there is clearly a reluctance in smaller non-company charities to invest time in training on accounting issues. So, it is not unusual to conduct a workshop with people from (perhaps) twelve different local charities, but to find that only one of the twelve was from an organisation where R&P accounts were actually an option.

- Where Charitable Incorporated Organisations were mentioned, some of those from smaller charitable companies (under £100,000) were attracted by the concept that if, in future their organisation converted to a CIO, that they would expect to be able to switch to preparing R&P accounts.

- For those without a formal accounting background, the biggest issue with the SORP framework is not the presentation, but the accruals basis – for example, understanding that fund balances may include debtors and fixed assets. However, many charity managers, and trustees with a non-accounting background clearly want to understand this even if external accountants are responsible for preparing the accounts, in order to be able to work meaningfully with their accountants. So it is clearly *not* the case that volunteers cannot be expected to understand the SORP regime. (Indeed, through ACIE a wide range of volunteers have accepted training as independent examiners, including in many cases, the ability to deal with SORP accounts within the IE income bands.)

- Those who have computerised accounting systems designed around accruals accounting (even if not charity-specific) tend find the accruals basis easier than those who are trying to account purely with manual books or spreadsheets.

- For those with little or no financial experience, even the R&P regime is difficult to understand from a workshop presentation, especially where multiple funds are involved, or where payments can be from petty cash or from the bank. Considerable one to one help is needed to get systems established and used consistently. So, even where the R&P basis is appropriate, it is clearly *not* the case that the R&P basis is so straightforward that hardly any accounting skills are needed.

- Understanding of the SOAL is very difficult for all. Professional accountants have difficulty with the idea of a financial statement which is purely a list that does not have to balance with anything else. Non-accountants find it hard to understand that they must still keep records of debtors and creditors for the SOAL, even though their books will be purely R&P based. Moreover, whilst most can understand the idea of unpaid bills leading to debtors and creditors, understanding that income received in advance needs to be noted as a liability on the SOAL is a very difficult concept – it really requires considerable appreciation of accruals accounting issues to prepare a SOAL properly.

These issues mean that even after a full day session on the charity accounting framework it is quite difficult for participants to give an informed opinion on whether or not they would choose R&P or accruals for a charity with (say) £50,000 income.

However:

- Some limited evidence was found (especially, though not exclusively in the church sector) of long-established charities where the treasurers were deliberately trying to keep the income below £100,000 – for example by discouraging new appeals – in order to avoid having to take on the demands of going into the accruals/SORP regime. These tended to be charities where there was little history of paying for professional assistance on accountancy matters.

- But in the case of relatively new charities with expected incomes over about £60,000, most staff and treasurers favoured using the accruals/SORP basis from the outset, so that no major change was needed if/when the charity went over the £100,000 level, and so that the charity presented the professionalism of SORP accounts when applying for funding.

7.5 Analysing the Range of Views

The most significant finding of this study is that there is no clear consensus, whether amongst independent examiners, funders, regulators, or charities themselves, on the suitability of R&P accounts for smaller charities.

Some find the simplicity of the R&P regime very attractive, and wholly appropriate to smaller charities, particularly in enabling those with less accounting experience to take responsibility for their charity's accounts. Others find the R&P basis to be so fundamentally flawed that they would impose the SORP/accruals framework even on the very smallest charities.

Moreover, this range of views emerges *both* from the independent examiners *and* from the funders. In fact, in considering the Likert scale scores from the statements presented in chapters 5 and 6, the mean scores are in most cases very similar for both groups of respondents – even though the range of views from each group of respondents was very large.

Also, it might have been expected that professional accountants would argue for the SORP/accruals basis, and non-accountants for the R&P basis, but this does not seem to be the case. There are professional accountants who feel passionately that R&P accounts are seriously flawed, whilst other professional accountants are actively encouraging smaller charities to take advantage of the simplicity of the R&P basis.

A spectrum of views has been thus identified, both from independent examiners and from grant-makers – views which can be summarised by the six bulleted positions in following table.

Table II: The Spectrum of Views on R&P Accounts

Support for SORP accounts in all cases

- *The law should force all charities to do SORP accounts whatever their size*
- *Even if the law allows R&P (as an independent examiner) I would always insist on SORP accounts for any charity for which I am acting or (as a funder) we would only consider SORP accounts from grant applicants*
- *Smaller charities cannot cope effectively with SORP and the accruals basis, so it is reasonable to allow them to do R&P accounts – but even for smaller charities R&P accounts are less reliable and SORP accounts are preferred*
- *Both approaches are OK – it is up to smaller charities to choose which they prefer, but either SORP or R&P is equally acceptable*
- *R&P is simpler and less work, so smaller charities should generally be encouraged to use the R&P basis*
- *R&P accounts have significant advantages in terms of giving factual information and less risk of misunderstanding: at least for smaller charities, they are clearly preferable to SORP accounts*

Use R&P accounts wherever possible

8. Conclusions and Recommendations

8.1 Summary of Main Findings

This study has sought to explore a wide range of issues concerning the R&P accounting regime for financial reporting by smaller UK charities (in comparison with the SORP/accruals basis, which is compulsory for charities over £100,000 income).

It has explored these issues both from a normative perspective in terms of what is legally required (chapter 3) and in terms of the views of two key groups of stakeholders: independent examiners, and funders – in each case with substantial postal surveys (chapters 5 and 6). It has also taken some account of the position of regulators and of charity staff and trustees (chapter 7).

The study has estimated in chapter 2 that around 80% of UK charities are entitled to adopt the R&P basis if they wish (and the majority of smaller charities clearly do so) – so the R&P regime accounts for the majority of sets of charity accounts produced each year.

Two fundamental problems were identified with the R&P regime and supported by the surveys, namely:

(1) There is a lack of a clear regulatory basis for R&P accounts in England & Wales (although the situation is much stronger in Scotland). This means that there is great uncertainty on what is actually needed in a set of charity financial statements prepared on the R&P basis. In chapter 3 of this report an attempt was made to document the legal minimum, drawing on issues from various aspects of the law. However, even independent examiners themselves are calling for clearer guidance on what is acceptable in practice. In the survey, both IEs and funders agreed by a large majority that R&P accounts presented a real risk of omitting crucial information. **This lack of a clear regulatory basis for R&P accounts in England & Wales creates real problems for charities seeking to produce accounts on this basis and present them to funders.**

(2) **Even those who are basically supportive of the R&P regime find a number of difficulties with the statement of assets and liabilities (SOAL).** Although most agree that the SOAL is important, the idea of a financial statement which can be presented purely as a list, not even necessarily with a monetary value on each line, is difficult to grasp. The idea that it does not have to balance to anything is fundamentally problematic. Both accountants and non-accountants find it hard to understand.

However, some of the other possible problems identified at the outset were not necessarily sustained – for example the suggestion that independent examiners might find it more difficult to report on R&P in terms of deciding when a qualified IE report was *not* supported – a majority of IE respondents disagreed with this proposition. Concerns were, however, felt on this by funders, who agreed in general that an IE's report on R&P accounts might not highlight real problems. This was the one area where the opinions of IEs and the opinions of funders showed significant divergence. Nevertheless, several funders made the point that so long as the accounts had received proper scrutiny by a named independent examiner, they did not mind whether which basis was used, and several IEs commented that a proper independent examination of R&P accounts could be used to remedy deficiencies, for example by requiring additional information in notes to the accounts.

What the study demonstrates most clearly, however, is that **amongst *both* stakeholder groups – IEs and funders – there are very clear views both for and against the use of R&P accounts by smaller charities,** as indicated by the spectrum of positions shown in table II on page 56.

Indeed, almost every statement offered in the surveys had significant numbers of respondents agreeing and disagreeing – sometimes in almost equal numbers. For example, the statement:

- *If I am acting as IE to a charity where the trustees have limited accounting experience, I would rather they presented their published accounts on an R&P basis*

gained a mean score from the IE respondents of 3.09 on the Likert scale (almost neutral) – not because most respondents had no strong views – but because the respondents agreed and disagreed in almost equal numbers (including large numbers who *strongly* agreed or *strongly* disagreed).

The equivalent statement presented to funders gave a very similar mean score of 3.2 – in other words, even where funders know that a charity has limited accounting experience, there is only a very slight preference for encouraging use of the R&P basis: for many the accruals/SORP basis is still superior.

In terms of the position of funders, there was strong agreement both from IEs working with charities, and from funders themselves, with the statement:

- *Most funders of voluntary organisations prefer to see accounts in SORP format.*

In terms of the funders' individual responses, some made clear that they were happy to accept accounts in whatever format the charity felt most appropriate (so long as they were independently examined) – but others indicated a strong preference for SORP accounts, even from the smallest charities, or certainly from those above £10,000-£20,000 income.

It is difficult for charities applying to grant-makers to know whether or not a particular funder is likely to downgrade applications without SORP accounts, so we may conclude that **charities seeking funding from a wide range of grant-makers will generally do better if they can produce accounts on the accruals/SORP basis, even if their income is well below £100,000.**

8.2 Recommendations to Policy-Makers

A number of issues thus emerge from this study which are relevant to policy-makers.

(a) The idea of offering smaller charities a simplified form of financial reporting has, to date, met with only partial success. Many IEs and many funders have significant reservations about the R&P regime – either in terms of R&P accounts omitting crucial information or failing to give a proper view *even in the context of small charities under £100,000 income.*

This view is by no mean universal, and may not even represent a majority, but those with concerns about R&P cannot be dismissed as a small minority. Moreover, even those who are basically positive about R&P accounts, and wish to encourage smaller charities to use the R&P basis, see problems in relation to what is actually required or in terms of the content of the SOAL.

If the R&P regime is to work properly as a framework for financial reporting by smaller charities, it would appear that **legislative changes are needed in England and Wales:**

- **to define more precisely what R&P accounts must contain** (perhaps following the Scottish regulations reproduced in Appendix A)
- **to consider major changes to the concept of the SOAL to make it more meaningful[24].**

(b) **Unless/until such changes are made, any suggestion of increases in the £100,000 R&P upper threshold should be put on hold.** There is far too little confidence in the R&P regime at present to justify increasing the threshold – indeed a number of respondents, both IEs and funders, felt the limit should be *lowered.* One respondent argued for aligning this with the £50,000 upper limit for R&P accounts in the public sector (for town and parish councils[25]); some argued for even lower limits.

At present, it seems most funders are *just about willing* to accept R&P accounts submitted with funding applications from organisations under £100,000 income. But there is evidence from this study that a number of funders strongly favour accruals/SORP accounts. If the £100,000 limit were raised, there is a real possibility either:

- that some funders would *insist* on accruals accounts, even if the limit were raised – thus negating any advantage from a relaxation in the regulations; or
- that those charities who took advantage of the raised threshold and only produced R&P accounts at higher income levels could lose out on funding.

(c) **Pending any new legislation, attempts should be made to produce a standard for charity R&P accounting** on similar lines to SORP, which has the support of the Accounting Standards Board, and which professional accountants can therefore endorse and follow without any sense that they are "breaking the rules" of accounting.

(d) **Much more training is needed on the R&P regime** – this needs to address professional accountants working with charities, others acting as independent

[24] A possible way forward might be to retain the SOAL, but with a requirement to provide at least an estimated value for each line, together with reconciliation of movements in SOAL values from one year to the next, possibly along the lines of a cashflow reconciliation in company accounts under FRS1 (but simplified as much as possible). This would address the concerns of those who see the SOAL as meaningless and not balancing with anything else, but would still allow the charity to continue to account primarily on a cashflow basis.

[25] See Richards and Harrop (2001).

examiners, funders, and anyone advising voluntary organisations on accounting issues.

In particular the following actions are suggested.

- Given that many more charities are accounting on the R&P basis than on the SORP basis, regulators should consider allocating more resources to supporting charities and in developing appropriate guidance for R&P accounts.

- The Charity Commission should be encouraged to put more effort into publicising the R&P guidance material (primarily CC16) which it has produced – not just to charities but also to the accounting profession

- Specialist charity groups within the accountancy professional bodies should be encouraged to offer seminars and workshops specifically on R&P accounting.

- Voluntary sector infrastructure bodies should be encouraged to offer training in R&P accounting – offered at times which are convenient to volunteers – and to target the smaller non-company charities which need this.

- Regulators need the resources to review at least a sample of the accounts filed by smaller charities, and to provide feedback when what is submitted is manifestly inadequate – so that the worst excesses of R&P accounts (especially those with no SOAL or no IE report) are addressed.

8.3 Conclusion

This study has shown very clear views both for and again R&P accounting by charities, from a range of stakeholders.

On balance, most respondents agreed that it is right to allow small charities (up to £100,000 income) to produce R&P accounts.

Moreover, unless regulations are made otherwise, the implementation of Charitable Incorporated Organisations under the Charities Act 2006 (which will be corporate bodies but *not* companies) will allow CIOs up to £100,000 income (or whatever threshold is finally agreed) to follow the R&P basis for their accounts. This gives added impetus to make sure the R&P regime is clear, effective and adequately supported.

The R&P regime for charity accounting is not in any sense fundamentally flawed. Whilst there will always be some accountants and users of accounts who prefer accruals-based financial statements, whatever the size of the organisation, *most* respondents to this study see considerable benefits for smaller charities from the simplicity that the R&P regime offers.

But at present there are still many concerns about the regime, largely as a result of general uncertainty of what is needed (in the absence of specific regulation) and particular concerns about the SOAL. However, these are not fundamental problems – they can be fixed. Ideally

further legislation is needed, but major progress could be made by means of an accounting standard for R&P accounts, subject to the support of the accountancy profession.
There would be considerable benefits from many parties in devoting time and effort to focus on the R&P regime.

- It is suggested that regulators should consider allocating more time and resources to the R&P regime, which is used by the majority of charities (rather than devoting so much attention to the SORP).

- Likewise, IEs (especially, perhaps, those who are professional accountants) need time and effort to ensure that they understand the R&P guidance available, so they can support charities to use the R&P basis where appropriate.

- Users of charity accounts (especially funders) need support to understand (a) what is required in properly prepared R&P accounts and (b) where such accounts are presented by grant applicants, to ensure they are effectively considered.

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Appendix A: R&P Accounting: The Legal Requirements

England and Wales

The legal requirements for charity accounting on the R&P basis in England and Wales comprises just a single subsection 42(3) of the *Charities Act 1993* as amended:

Section 42 – Annual Statements of Accounts

(3) Where a charity's gross income in any financial year does not exceed £100,000, the charity trustees may, in respect of that year, elect to prepare the following, namely—

(a) a receipts and payments account, and

(b) a statement of assets and liabilities,

instead of a statement of accounts under subsection (1) above.

Note: The figure of £100,000 was substituted with effect from 1 March 1996 (the date when this part of the Act came into force) by SI. 1995/2696 [when enacted, the figure was £25,000]. No further amendment to this subsection was made by the Charities Act 2006. The reference to "subsection (1) above" refers to the normal statement of accounts on the accruals basis, complying with regulations.

Scotland

The following is an extract from the *Charities Accounts (Scotland) Regulations 2006* showing the current requirements for Scottish charities preparing accounts on the R&P basis. The Regulations are made under powers in section 44(4) of the *Charities and Trustee Investment (Scotland) Act 2005*.

As explained in chapter 2, the Scottish Regulations provide a detailed framework for charity accounting on the R&P basis – as shown above there are no equivalent regulations in England and Wales. These Regulations thus represent the only situation at present in the UK where a *mandatory framework* governs the presentation of R&P accounts.

(However, it should be noted that an E&W charity under £100,000 might also be registered with OSCR if it had regular activities in Scotland, and in such cases these regulations could also apply to an English or Welsh charity.)

Schedule 2 to the Regulations, which covers the requirements for the Trustees Annual Report with R&P accounts, is not included in this extract.

Statement of account - Receipts and payments accounts

9.—(1) Subject to regulation 14(4) and to paragraph (4), a charity with a gross income of less than £100,000 in a financial year shall prepare a statement of account for that financial year consisting of–

(a) a receipts and payment account;

(b) a statement of balances as at the last day of the financial year;

(c) notes to the accounts; and

(d) an annual report containing the information listed in Schedule 2.

(2) The statement of balances and the annual report shall be signed by one of the charity trustees on behalf of all the charity trustees as authorised by them and shall specify the date on which the statement of account of which the statement of balances and the annual report forms part was approved by the charity trustees.

(3) The statement of account shall contain the information listed in Schedule 3.

SCHEDULE 3

Receipts and Payments Accounts

PART 1

Information to be shown on the receipts and payments account and on the statement of balances

1. In respect of every amount required to be shown in the receipts and payments account and in the statement of balances, the corresponding amount for the financial year immediately preceding that to which the receipts and payments account and statement of balances relate.

2. The receipts and payments account shall set out the total receipts and payments for the financial year in sufficient detail as may reasonably enable a proper appreciation of the transactions and the excess of receipts over payments or payments over receipts for that year and shall distinguish between restricted, unrestricted, expendable endowment or permanent endowment funds.

3. The following receipts in particular, if any, shall be shown separately:–

(a) donations;

(b) legacies;

(c) grants;

(d) receipts from fundraising activities;

(e) gross trading receipts;

(f) income from investments other than land and buildings;

(g) rents from land and buildings;

(h) gross receipts from other charitable activities;

(i) proceeds from sale of fixed assets; and

(j) proceeds from sale of investments.

4. The following payments in particular, if any, shall be shown separately:–

(a) expenses for fundraising activities;

(b) gross trading payments;

(c) investment management costs;

(d) payments relating directly to charitable activities, detailing material items;

(e) grants and donations relating directly to charitable activities;

(f) governance costs relating to–

(i) audit or independent examination;

(ii) preparation of annual accounts; and

(iii) legal costs associated with constitutional matters or trustee advice;

(g) purchases of fixed assets; and

(h) purchase of investments.

5. The receipts and payments account shall set out transfers from a restricted, unrestricted, expendable endowment or permanent endowment fund into another fund separately.

6. The statement of balances shall–

(a) distinguish between unrestricted, restricted, expendable endowment or permanent endowment funds;

(b) reconcile the cash and bank balances at the beginning and end of the financial year with the surplus or deficit shown by the receipts and payments account;

(c) summarise the holding of investments and market valuation;

(d) summarise other assets including gifted assets and state the cost or a valuation of the assets if available, and where the charity trustees consider the valuation to be lower than the cost, state the valuation;

(e) state an estimate of the liabilities at the end of the financial year showing separately any contingent liabilities.

PART 2

Additional information to be provided by way of notes to the accounts

In respect of the receipts and payments account and statement of balances, except where provided in the annual report–

(a) the nature and purpose of each of the funds including any restrictions on these funds;

(b) the number and amount of grant or grants paid, the type of activity or project supported and whether the grant or grants was or were made for the benefit of an individual or an institution;

(c) the amount of remuneration paid to a charity trustee or person connected with a trustee, the authority under which the remuneration was paid, and if no remuneration was paid to a charity trustee or a person connected to a trustee, a statement of that fact;

(d) the aggregate amount, if any, of expenses paid to the charity trustees, detailing the number of charity trustees paid and if no expenses were paid, a statement of that fact;

(e) the nature of any transactions between charity trustees and persons connected with a trustee, the nature of the relationship, the transaction amount and any outstanding balances at the end of the financial year of the charity;

(f) such other information as may reasonably assist the user to understand the statement of accounts.

Appendix B: The Survey Questionnaires

Both survey questionnaires – with members of ACIE (see chapter 5) and with members of ACF (see chapter 6) sought to focus on *attitudinal issues* regarding the use of R&P accounts or accruals/SORP accounts for smaller charities.

The Survey to ACIE Members

TO: ALL MEMBERS OF THE ASSOCIATION OF CHARITY INDEPENDENT EXAMINERS

Dear Colleague

As you will have read from articles in *IE*, the Centre for Voluntary Sector Research at Sheffield Hallam University is undertaking a research project for ACIE looking at various policy issues in charity accounting. For the current year, the ACIE Council has asked us to focus on issues related to the use of ***receipts and payments accounts*** (R&P) for charity financial statements.

We will also be seeking some external views, but we are particularly keen to have the opinions of ACIE members - *whether or not you work with R&P accounts yourself.* We would therefore invite you to complete and return this questionnaire - please send it back in the enclosed Sheffield Hallam University reply-paid envelope as soon as possible and certainly not later than 27 March 2006. If there is not enough space, please feel free to attach additional sheets - or you can e-mail me at *gareth.morgan@shu.ac.uk*.

The results will be used in a paper being presented to the British Accounting Association Annual Conference in April, and a summary will also appear in a future issue of *IE*. Thank you for your help in this study.

Dr Gareth G Morgan *February 2006*

INTRODUCTION

As you will know, charities in England and Wales (provided they are not companies) with income below £100K have the option of producing their accounts *either*

- on an R&P basis - with a receipts and payments account and statement of assets and liabilities *OR*
- on an accruals basis, following the requirements of the Charities SORP.

(In Scotland the limit for R&P accounts is currently £25K but due to increase shortly.) This questionnaire is about this distinction between charity accounts on the accruals basis and the R&P basis.

1. USE OF CHARITY ACCOUNTS	*Charity accounts which I am involved in preparing*	*Charity accounts which I independently examine or audit*
(a) Approximately how many sets of charity accounts do you deal with each year? (Please give figures in the columns indicated.)		
(b) How many of these (for each column) are presented on a *receipts and payments basis*?		
(c) How many of these are presented on an accruals basis in accordance with the Charities SORP (SOFA, balance sheet, notes)?		
(d) How many (if any) are presented on any other basis - please give details		

2. OPINIONS ON ISSUES WITH R&P ACCOUNTS

Some of the following comments have been heard from participants at courses and seminars on charity accounts. *Please mark each statement to indicate how far you agree or disagree with the comment.*
(All these comments apply to charities of a size whether there is a choice between the two methods of accounting - accruals or R&P.) Please circle a number alongside each comment as follows:

1 = Strongly disagree 2 = Disagree somewhat 3 = Neither agree nor disagree 4 = Agree somewhat 5 = Strongly agree

(If you have no opinion on a comment, or if it is never applicable to you, please circle NA.)

(a)	"R&P accounts are easier to understand by those who are not accountants."	1 2 3 4 5 NA
(b)	"Starting from the typical books of a charity treasurer or bookkeeper, it is a good deal quicker to prepare R&P accounts than to do a full set of accruals accounts in SORP format."	1 2 3 4 5 NA
(c)	"The trouble with R&P accounts is that even for smaller organisations, they rarely give a proper view of the charity's financial position."	1 2 3 4 5 NA
(d)	"Funders and donors often misinterpret accruals accounts - for example by forgetting that the fund balances include fixed assets - R&P has less risk of misunderstanding."	1 2 3 4 5 NA
(e)	"There is a real danger with R&P accounts that, with few rules on what's required, a charity may omit crucial details which ought to be shown in a note to the accounts."	1 2 3 4 5 NA
(f)	"If I am acting as IE to a charity where the trustees have limited accounting experience, I would rather they presented their published accounts on an R&P basis."	1 2 3 4 5 NA
(g)	"The *statement of assets and liabilities* (SOAL) is crucial in understanding charity accounts on an R&P basis."	1 2 3 4 5 NA
(h)	"Most funders of voluntary organisations prefer to see accounts in SORP format."	1 2 3 4 5 NA
(i)	"It is hard for independent examiners to report on R&P accounts because there are few rules about presentation, so it is difficult to decide when the accounts are poor enough to need a qualified IE report."	1 2 3 4 5 NA
(j)	"I think all charities should have to do SORP accounts, whatever their size."	1 2 3 4 5 NA
(k)	"I agree that *cash is king*. With R&P accounts you can see exactly what has been going on - accruals accounts allow too much scope for manipulation."	1 2 3 4 5 NA

3. YOUR OWN VIEWS

Do you have *any other comments* on the advantages or disadvantages of R&P accounts?

4. ABOUT YOURSELF

(a) Which of the following best describes you?

- ☐ I am a professional accountant
- ☐ I am an experienced independent examiner (IE), but not a professional accountant
- ☐ I am fairly familiar with charity accounts but have limited or no IE experience
- ☐ I am new to working with charity accounts and I am not an accountant

(b) Your gender: ☐ M ☐ F

(c) Your age: ☐ Under 30 ☐ 30 - 39 ☐ 40 - 49 ☐ 50-59 ☐ 60-69 ☐ 70+

The Survey to ACF Members

TO: ALL MEMBERS OF THE ASSOCIATION OF CHARITABLE FOUNDATIONS

Dear Colleague

At the Centre for Voluntary Sector Research at Sheffield Hallam University we are undertaking a research project regarding accounts of smaller charities. **We are particularly interested in exploring how accounts of smaller groups are used by funders.** Aside from the legal requirements regarding charity accounts, we know that one of the main reasons why charities produce accounts is to be able to send them to funders.

For charitable organisations with income up to £100,000 (provided they are not companies) the Charities Act 1993 (for England & Wales), and the Charities and Trustee Investment (Scotland) Act 2005 both now allow a choice of producing year end accounts on a **receipts and payments basis *(R&P)*** or on an **accruals basis following the Charities SORP.** We are keen to find what funders feel about this - in terms of the accounts you receive from groups applying to you for funding. So we are delighted that ACF has kindly agreed to support the study by circulating this questionnaire to members.

This study was originally commissioned by the Association of Charity Independent Examiners, as smaller charities often look to their independent examiners (IEs) to guide them on these issues. We have already sought the views of IEs on this issue - but the view of grant-makers is critical.

We would therefore invite you to complete and return this questionnaire - please send it back in the enclosed Sheffield Hallam University reply-paid envelope as soon as possible and certainly not later than 14 December 2007. We have kept it to just two sides, but **if you would like to add further comments, please feel free to attach additional sheets - or you can e-mail me at *gareth.morgan@shu.ac.uk***.

The results will be brought together in a paper to be published early next year (copies available on request) and it is hoped that a summary will also appear in a future issue of *T&F News*. Thank you for your help.

Professor Gareth G Morgan *November 2007*

INTRODUCTION

This questionnaire is about the distinction between charity accounts on the accruals basis (SORP format) and the R&P basis *from the perspective of a funder* considering a grant application (or monitoring an existing grant) to a group or organisation with charitable status but where the organisation has **under £100,000** annual income.

1. (a) Does your trust or foundation make grants to organisations of this kind? Yes/No

   (b) If yes, approximately how many grant per annum are in this category? ………
   (I.e. Your approx number of grants to charitable organisations under £100,000 income)

   (c) Do you require grant *applicants* to submit their previous years accounts? Yes/No

   (d) Do you require grant *recipients* to submit their accounts (after grants have been made)? Yes/No

   (e) Please explain in general terms how applicants' accounts (from smaller organisations) are used in your grant-making processes and the importance you attach to this. (Feel free to enclose any additional material which may be relevant.)

   ………

   ………

If your answers are "No" to all of Q1, please just return the questionnaire - no need to complete the other questions.

2. OPINIONS ON ISSUES WITH R&P ACCOUNTS

Some of the following comments have been heard from participants at voluntary sector events. *Please mark each statement to indicate how far you agree or disagree with the comment* ***from your perspective as a funder****.*

(All these comments apply to non-company charities under £100K income - where there is a choice between the two methods of accounting - accruals or R&P.) Please circle a number alongside each comment as follows:

1 = Strongly disagree 2 = Disagree somewhat 3 = Neither agree nor disagree 4 = Agree somewhat 5 = Strongly agree

(If you have no opinion on a comment, or if it is never applicable to you, please circle NA.)

(a)	"R&P accounts are easier to understand by those who are not accountants."	1 2 3 4 5 NA
(b)	"I feel it is less work for smaller charities to produce R&P accounts than to do a full set of accruals accounts in SORP format - even if their accountant or independent examiner handles most of the preparation."	1 2 3 4 5 NA
(c)	"The trouble with R&P accounts is that even for smaller organisations, they rarely give a proper view of the charity's financial position."	1 2 3 4 5 NA
(d)	"It is easy to misinterpret accruals accounts - for example by forgetting that the fund balances include fixed assets - R&P has less risk of misunderstanding."	1 2 3 4 5 NA
(e)	"There is a real danger with R&P accounts that, with few rules on what's required, a charity may omit crucial details which ought to be shown in a note to the accounts."	1 2 3 4 5 NA
(f)	"As a funder, if we are dealing with a charity where the trustees have limited accounting experience, I would rather they presented their published accounts on an R&P basis."	1 2 3 4 5 NA
(g)	"The *statement of assets and liabilities* (SOAL) is crucial in understanding charity accounts on an R&P basis."	1 2 3 4 5 NA
(h)	"Most funders of voluntary organisations prefer to see accounts in SORP format."	1 2 3 4 5 NA
(i)	"We would have less confidence that an independent examiner's report on R&P accounts would highlight real problems."	1 2 3 4 5 NA
(j)	"I think all charities should have to do SORP accounts, whatever their size."	1 2 3 4 5 NA
(k)	"I agree that *cash is king*. With R&P accounts you can see exactly what has been going on - accruals accounts allow too much scope for manipulation."	1 2 3 4 5 NA

3. YOUR OWN VIEWS

Do you have *any other comments* on the advantages or disadvantages of R&P accounts in terms of smaller organisations applying to you for funding?

4. ABOUT YOURSELF

(a) What is your role in the grant-maker you are responding from: ………………………………………

(b) In framing your responses, how would you describe your own knowledge/experience of charity accounts?

- ☐ I am a professional accountant
- ☐ I am an experienced in preparing charity accounts but not a professional accountant
- ☐ I am fairly familiar with *reading* charity accounts but not the actual preparation
- ☐ I have little experience of charity accounts.