

**EXPLANATORY MEMORANDUM TO**  
**THE CHARITIES (ACCOUNTS AND REPORTS) REGULATIONS 2005**  
**2005 No.572**

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

**2. Description**

2.1 Regulations to give legal effect to the methods and principles of the Statement of Recommended Practice: Accounting and Reporting by Charities (the Charities SORP).

2.2 The Charity Commission is the SORP-making body for Charities in the UK. The Charities (Accounts and Reports) Regulations adopt the "methods and principles" of the Charities SORP. SORPs form part of UK Generally Accepted Accounting Practice which evolves as standards change, and SORPs are required by the Accounting Standards Board's code of practice to be reviewed annually and updated as necessary to reflect changes in accounting standards and sector developments.

2.3 Investment Fund Charities do not have to comply with the Charities SORP. Instead the existing Regulations provide accounting and reporting requirements which are consistent with the SORP for Authorised Unit Trust Schemes, published by the Investment Management Regulatory Organisation in 1991. These requirements have been superseded by the SORP for Financial Statements of Authorised Funds, published by the Investment Manager Association in November 2003. These Regulations reflect this change. The Regulations also change the requirements for disclosures provided in the accounting and reporting responsibilities of investment fund charities. There are fewer than 50 investment fund charities registered with the Charity Commission which would be affected by the Regulations.

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

3.1 None

**4. Legislative Background**

- 4.1 Part VI of the Charities Act 1993 provides the accounting and reporting framework for charities. It confers powers on the Secretary of State to make regulations to support the accounting and reporting framework, which primarily provide for:
- a) The content of charities' annual reports;
  - b) The form and content of charities' accounts;
  - c) The methods and principles adopted in preparing charities' accounts; and,
  - d) Information to be provided by way of notes to charities' accounts.
- 4.2 The Charities (Accounts and Reports) Regulations 2000 (2000 No. 2868) currently make provision for the form and content of charity accounts, the methods and principles adopted in their preparation, notes to the accounts, and for an annual report containing information on the activities of the charity, along with other information about the charity, its trustees and officers. The Charities (Accounts and Reports) Regulations 1995 (1995 No. 2724) also currently make provision for determining the financial year and duties of charity auditors and independent examiners and the reports which they are required to make, together with their rights to information and explanations necessary for their audit or examination.

## **5. Extent**

- 5.1 This instrument applies to England and Wales.

## **6. European Convention on Human Rights**

Not applicable

## **7. Policy background**

- 1.1. The Cabinet Office Strategy Unit report 'Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector' (September 2002) made a number of recommendations for changes to the legal and regulatory framework for the charitable and wider not-for-profit sector. The responses to the public consultation on this report, which ran from September 2002 to December 2002, demonstrated considerable support for many of the proposals. The Government's response to the review, 'Charities and Not-For-Profits: A Modern Legal Framework' was published in July 2003.
- 1.2. Several of the Strategy Unit recommendations applied to charities accounting and reporting, including, in particular, the following -

- a) The next charities SORP should develop improved methods for apportioning costs and expenditure, enabling more meaningful financial comparisons between organisations to be made.
  - b) Improvements should continue to be made to the SORP to strengthen its focus on achievements against objectives, organisational impact and future strategy.
  - c) For charities with a total annual income of over £1 million, the Charities (Accounts and Reports) Regulations 2000 should be amended in line with the obligations of pension fund trustees to declare their ethical investment stance in their annual reports.
  - d) Smaller charities which have significant holdings of equities should also have to make a declaration of their ethical investment stance on a voluntary basis, as a matter of good practice.
- 7.3 The proposals for the Charities SORP are drawn up by the Charities SORP Committee, and advisory committee made up of charity finance directors, charity auditors, academics, advisers, and charity regulators. An exposure draft of the new Charities SORP was published for comment in July 2004, with consultation closing on 1 October 2004. The revised Charities SORP was published on Friday 4 March 2005 having received its ASB certificate on 28 February 2005, and these Regulations will give legal effect to its methods and principles. Draft Regulations were published for consultation on 24 November 2004, and the consultation closed on 18 February 2005.

## **8. Impact**

- 8.1 Separate Regulatory Impact Assessments have been prepared for general charities and for investment fund charities. Copies are attached to this memorandum.
- 8.2 The threshold for the preparation of an annual report is annual income (or expenditure) over £10,000. The impact of additional requirements in the new Regulations however is on auditable charities which are those with an annual income over £250,000 other than currently excepted or exempt charities. The Commission can require an excepted charity to produce an annual report, in which case the requirements would apply.
- 8.3 The accounting requirements in the draft Regulations would apply to non-company charities in England and Wales with an annual income over £100,000, which are required to produce accrual accounts. Non-

company charities with an annual income below £100,000 may opt to produce accrual accounts. The accounting requirements would not apply to currently exempt charities and charities in company form.

8.4 The main impacts on those charities that will be affected by the Regulations, would be one-off costs in training staff, and implementing changes to preparing accounts and annual reports. There would also be one-off costs in training for charities' auditors.

8.5 These regulations will not have a noteworthy impact on public expenditure. Their impact would be limited to the Charity Commission, and would be financed from within its resource allocation.

## **9. Contact**

Ben Harrison at the Home Office Tel: 020 035 5357 or e-mail: [ben.harrison7@homeoffice.gsi.gov.uk](mailto:ben.harrison7@homeoffice.gsi.gov.uk) can answer any queries regarding the instrument.

**CHARITIES  
(ACCOUNTS AND REPORTS)  
REGULATIONS 2005**

**REGULATORY IMPACT ASSESSMENT  
FOR  
CHARITIES  
(OTHER THAN INVESTMENT FUND CHARITIES)**

**MARCH 2005**

## **1. Proposal**

- 1.1 This Regulatory Impact Assessment (RIA) examines the impact of the introduction of new accounting and reporting Regulations to replace those currently placed on charities (other than Investment Fund Charities) in England and Wales by The Charities (Accounts and Reports) Regulations 2000 SI 2868 and The Charities (Accounts and Reports) Regulations 1995 SI 2724. The impact on Investment Fund Charities is examined in a separate RIA.

## **2. Purpose and intended effect of measure**

### **2.1 The objective**

- 2.1.1 The accounting requirements of the Regulations make provision for the form and content, methods and principles and notes to the accounts. The objective of the proposed changes is to ensure the accounting requirements continue to provide a framework relevant to charities' reporting needs and to maintain appropriate accountability to a charity's stakeholders and the wider public for the resources they control. The proposed changes seek to enhance consistency in financial reporting and to enable the application of UK Generally Accepted Accounting Practice (UK GAAP) in a manner consistent with charity sector financial reporting needs and the particular transactions undertaken within the charity sector. In particular the Regulations are updated to adopt the methods and principles of the proposed revision of the "Statement of Recommended Practice: Accounting and Reporting by Charities" (the Charities SORP) which has taken forward, as part of its revision, key recommendations contained in The Strategy Unit Review "Private Action, Public Benefit" which was published in September 2002.
- 2.1.2 The annual reporting Regulations provide for a review of the activities of the charities with an objective of enabling the reader to interpret better the financial information provided within the accounts as well as providing other information relating to the charity, its trustees or officers. The objective of these changes is to ensure this framework remains relevant to the reporting needs of charities and users of the annual report. The proposed changes again take forward key recommendations of the Strategy Unit Review in particular by strengthening the reporting focus on achievements against objectives.

### **2.2 Devolution**

- 2.2.1 The Regulations only apply to charities in England and Wales and would not impact on charities based in Scotland and Northern Ireland.
- 2.2.2 The Scottish Executive is preparing to consult on new charity accounting and reporting Regulations for Scotland to take effect when

the Charity and Trustee Investment (Scotland) Bill is implemented. These Regulations are being drawn up taking account of the expected revision of the Charities SORP.

## **2.3 The background**

### **Legal framework**

2.3.1 Part VI of the Charities Act 1993 (the Act) provides the accounting and reporting framework for charities. Part VI of the Act confers powers upon the Secretary of State to make Regulations to support the accounting and reporting framework. The proposals primarily affect the Regulations made under Sections 42 and 45 which provide for:

- the content of the annual report;
- the form and content of accounts;
- the methods and principles adopted in preparing accounts; and
- information to be provided by way of notes to the accounts.

### **Accounting requirements**

2.3.2 The existing Regulations require the methods and principles of the Statement of Recommended Practice: Accounting and Reporting by Charities (the Charities SORP) issued in October 2000 to be applied by charities in preparing their accounts. The Charities SORP provides specific recommendations for the implementation of UK GAAP in the context of the particular circumstances of charities. It is published by the Charity Commission, as the SORP-making body, and is prepared under the Accounting Standards Board's (ASB) code of practice for SORPs which includes public consultation on the recommendations that are developed in conjunction with an independent advisory committee.

2.3.3 UK GAAP and developments in charity accounting are not static and the Charities SORP must, under the ASB's code of practice, be reviewed regularly to ensure its recommendations keep pace with change. Since the publication of the Charities SORP in October 2000 there have been a number of significant changes to Financial Reporting Standards and the ASB has also issued a Proposed Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting.

2.3.4 The Strategy Unit Review also identified in its recommendations, areas where the Charities SORP could be developed to assist financial comparability and strengthen its focus on achievements against objectives. The Government supported these recommendations

recognising that the development of these issues should take place within the context of the SORP-making process.

- 2.3.5 The Government also indicated a willingness to support these developments through necessary amendment to the accounting and reporting Regulations. Responding to these changes and developments a review of the Charities SORP has been undertaken with a view to issuing an updated SORP early in 2005. It is necessary for the new Regulations to disapply the existing Charities SORP to facilitate the issue of its revision and to adopt the methods and principles of the revised Charities SORP so that law and recommended practice are consistent and come into play at the same time.
- 2.3.6 The charity sector has played an active role both in informing the Strategy Unit Review and in researching and developing proposals for the future development of the Charities SORP. Research projects such as the Charity Finance Directors' Group's "Inputs Matter" project have assisted in identifying practical issues arising from the existing Charities SORP and research work sponsored by the Institute of Fundraising identified issues relating to the classification of fundraising costs which have been taken forward by the SORP review. The work of the Association of Chief Executives of Voluntary Organisations (ACEVO) in relation to cost allocation contained in "Funding Our Future II: Understand and Allocate Costs" also informed the work of the SORP review.
- 2.3.7 The new Regulations will require charities to apply the methods and principles of the revised Charities SORP in preparing accounts and ensure information presented in notes to the accounts is consistent with its key recommended disclosures. The new Regulations, in so doing, will ensure the legal framework provided is consistent with the revised Charities SORP which addresses changes in UK GAAP, the accounting recommendation of the Strategy Unit Review and sector developments.

### **Annual Reports**

- 2.3.8 The Regulations also set out the legal requirements for an annual report prepared by the charity trustees. These legal requirements are supplemented by the more detailed recommendations and guidance provided by the Charities SORP. The annual report provides a review of the activities of the charities enabling the reader to interpret better the financial information provided within the accounts as well as providing other information relating to the charity, its trustees or officers.
- 2.3.9 There has been considerable public debate in recent years about how well charities report on the effectiveness and efficiency of their work. The National Audit Office (NAO) gave support in its recent report on the Charity Commission to the proposition that there was a need for



improvement to enable the reader to understand charities' objectives, structure, activities and achievements. The Strategy Unit Review also identified a need for the Charities SORP to strengthen its focus on reporting achievements against objectives, organisational impact and future strategy. These recommendations have been taken forward both in the new Regulations and the SORP review.

2.3.10 The new Regulations also take forward the Strategy Unit Review's recommendations for the annual report to contain governance information in relation to the induction and training of new trustees and to provide information to supporters as to any ethical stance taken by a charity in determining its investment policies.

## **2.4 Risk assessment**

2.4.1 In the absence of new Regulations the introduction of a revised Charities SORP would be problematic. SORPs need to be consistent with the legal requirements framework provided by the Regulations. Without updated Regulations the development of relevant accounting and reporting framework for charities would be impeded. In particular, the accounting and reporting recommendation of the Strategy Unit Review accepted by Government and taken forward in the SORP review could not be implemented.

2.4.2 A failure to introduce new Regulations gives rise to the following risks:

- the existing Charities SORP becomes of limited impact and with the passage of time less and less relevant in providing an authoritative and consistent interpretation of how accounting standards should be applied in the particular circumstances of the charity sector;
- the accounting Regulations fail to reflect developments in UK GAAP;
- inconsistent approaches and interpretations might be adopted within the charity sector with an increasing loss in comparability and transparency giving rise to an indirect impact on trust and confidence in the sector; and
- enhanced accountability (through more focused reporting of a charity's aims and objectives, activities undertaken and the resulting achievements) would be lost, inhibiting the development of performance reporting within the charity sector.

### **3. Options**

#### **3.1 Option 1: Retain the 1995 and 2000 Regulations**

- 3.1.1 This option may prevent the publication and issue of a revised SORP and result in the accounting framework set by Regulations not fully reflecting developments in UK GAAP. This is likely to result in the risks identified in the previous risk assessment section crystallising.
- 3.1.2 If a new Charities SORP were to be published and issued (notwithstanding the inconsistency this would create with legal requirements) this would create a dual regime whereby charities that are companies would adopt the revised Charities SORP to comply with UK GAAP while non-company charities could only comply by breaching legal requirements. This would fragment the accountancy framework applicable to charities and create a legal requirement for non-company charities inconsistent with UK GAAP creating two frameworks for the interpretation of true and fair.
- 3.1.3 Retaining the existing Regulations would also limit the impact of certain de-regulatory measures. In particular, the disclosure exemptions for smaller charities would continue to operate up to an income threshold of £250,000 rather than applying only where a statutory audit requirement existed. (The Charities Bill proposes a £500,000 income and £2.8 million assets).
- 3.1.4 Retaining the existing Regulations would prevent the implementation of certain key recommendations of the Strategy Unit's Report 'Private Action, Public Benefit' which have, following separate consultation, been accepted by Government.

#### **3.2 Option 2: Implement the Regulations**

- 3.2.1 This option involves the introduction of new Regulations replacing both the existing 2000 Regulations and 1995 Regulations. The new Regulations would be consistent with the revised Charities SORP and take forward those recommendations of the Strategy Unit Review endorsed by Government. The new Regulations would also consolidate existing provisions for the financial year of a charity, the reporting duties and rights of auditors and independent examiners, contained in the 1995 Regulations.

## **4. Benefits**

### **4.1 Option 1: Retain the 1995 and 2000 Regulations**

4.1.1 Retaining the existing Regulations might in theory result in no increase in compliance costs. However, in addition to impeding the application of a revised SORP and enhanced annual reporting, indirect costs would arise. In particular, charities would need to determine individually how to apply developments in UK GAAP to their particular circumstances in the absence of authoritative guidance provided through the revised Charities SORP.

### **4.2 Option 2: Implement the Regulations**

4.2.1 The new Regulations ensure the continued relevance of the accounting and reporting framework. In particular they:

1. ensure accounting methods and principles adopted in preparing charities' accounts are those of the revised Charities SORP;
2. ensure information provided by notes to the accounts are presented in a manner consistent with the revised Charities SORP;
3. ensure the Regulations are consistent with developments in UK GAAP; and
4. enable Strategy Unit Review recommendations accepted by Government to be carried forward.

4.2.2 The Strategy Unit Review indicated that better information would not only boost public confidence and assist decision-making but could, by focusing attention in this area, strengthen incentives for charities to evaluate and improve their performance. The new Regulations, in strengthening governance reporting and the reporting of achievements against objectives, seek to contribute to the development of a clearer focus on the reporting performance. The contribution such reporting makes to the efficiency and effectiveness of the sector is impossible to gauge. However, if the sector's effectiveness improved by only a tenth of one percent (0.1) of the income of those charities affected (£31.9 bn) this would result in benefits of £31.9 m.

## **5. Business sectors affected**

5.1 There are approximately 9,900 non - company charities registered with the Charity Commission with income in excess of £100,000 who must produce accruals accounts. That said, several hundred of these charities will be Registered Social Landlords or Further and Higher Education Institutions which will not be required by the Regulations to

follow the methods and principles of the Charities SORP, as a more specialist SORPs apply.

- 5.2 The accounting requirements of the Regulations apply to excepted charities but such charities are not required to produce an annual report unless directed by the Charity Commission to do so. The exact number of excepted charities is not precisely known but in 2000 it was estimated at over 100,000 which includes many Scout and Guide charities, various religious charities, armed forces charities and some charities owning foundation schools. We are aware that some groups of excepted charities might not currently be following the accounting requirements of the Regulations. The vast majority of such charities have incomes well below the £100,000 income threshold that requires the preparation of accruals accounts. We estimate that up to 5,000 excepted charities might have annual income in excess of £100,000.
- 5.3 The accounting and reporting requirements of the Regulations do not apply to exempt charities although non-departmental public bodies (NDPBs) with charitable status follow the requirements of the Charities SORP in order to comply with government accounting requirements but not the Regulations.
- 5.4 Charities that are companies are not affected by the accounting requirements of the Regulations but will apply the methods and principles of the Charities SORP to assist in their compliance with UK GAAP. The annual reporting requirements of the Regulations do however apply to charitable companies. There are approximately 8,000 charitable companies with an income over the £250,000 income threshold that would be affected by the additional annual reporting requirements of the new Regulations.
- 5.5 Those who scrutinise (audit or examine) the accounts of charities will need reasonable knowledge of the new Regulations and the methods and principles of the revised Charities SORP. We have no precise data as to the number of accountancy practices or independent examiners actively involved in charity scrutiny assignments. We estimate that up to 1,000 audit engagement partners and 1,000 individuals who offer independent examination services may be affected.

## **6. Race impact assessment**

- 6.1 It is not considered that the proposed changes will bring disproportionate benefits or costs to any particular group. Research conducted by the Council for Ethnic Minority Organisations (CEMVO) suggests that the majority of BME organisations are small, with an income of less than £10,000 per annum, and so would not be affected by the proposed Regulations.

## **7. Sustainable development**

- 7.1 Consideration has been given to whether these proposals will have costs or provide benefits to environmental protection, social values and progress, or the economy's long term growth and development. The proposals for charities to disclose any ethical investment policy could have a positive long term impact in this regard. The proposals would not lead to any disproportionate adverse impact.

## **8. Costs**

### **8.1 Compliance costs**

- 8.1.1 There will be no compliance costs for other businesses as the Regulations affect only the Charity sector.

### **8.2 Option 1: Retain the 1995 and 2000 Regulations**

- 8.2.1 If the Regulations are not changed, an indirect cost will arise through each individual charity having to determine how developments in UK GAAP should be applied. The existing methods and principles applied by the Regulations would have to be updated for developments in UK GAAP which have occurred since October 2000 and interpreted by each individual charity. In so far as a failure to update the Regulations could impede the issue of a revised Charities SORP, any indirect cost would also impact on charities which are not companies.

- 8.2.2 It is estimated that charities with:

1. income of over £10m would need at least three days' private study to assimilate changes to UK GAAP;
2. income of between £1m and £10m would require at least one and a half days;
3. income over £100K but below £1m are likely to place greater reliance on their auditor or independent examiner to help ensure

implementation of the UK GAAP although some background study of a day is estimated;

4. exception from registration would adopt a similar approach to that of the £100k to £1m income band.

8.2.3 Using these assumptions and based on the following cost estimates:

Cost of Staff time per day (larger charities over £10m)	£200 per day (assuming staff pay of £50,000 per annum,
Cost of Staff time (charities £1m to 10m)	£140 per day (assuming staff pay of £35,000 per annum)
Cost of Staff time per day (less than £1m)	£100 per day (assuming staff pay of £25,000)

The following costs arise:

Income band/category	Non-Company charities	Company Charities	Days	Cost per day £	Total Cost £
Over £10m	138	365	1,509	200	301,800
£1m to £10m	1,016	2,985	6,002	140	840,280
£100k to £1m	8,757	8,730	17,487	100	1,748,700
Excepted charities	5,000**	-	5,000	100	500,000
<b>Total</b>	<b>14,911</b>	<b>12,080</b>	<b>29,998</b>		<b>£3,390,780</b>

\* based on Charity Commission's register profile at 30 September, 2004.

\*\* excepted charities assumed to be non-company charities.

### 8.3 Option 2: Implement the Regulations

8.3.1 The introduction of a revised Charities SORP creates a compliance cost in terms of creating a need for charities to familiarise themselves with the revised accounting recommendations which may involve a training cost. The revision results in certain modifications to the format of the SoFA that may also involve amendments to comparative figures and in certain cases changes to the accounting policies for the recognition of assets and liabilities.

8.3.2 In quantifying compliance costs resulting from the new Regulations, it needs to be recognised that, in the absence of Regulations, the recommendations of the Charities SORP would nevertheless be indicative of how charities meet the legal requirement to present a true and fair view. It can be argued that the compliance cost arises primarily through the introduction of a revised SORP and from developments external to the Regulatory process. The alternative view

would be to attribute to the Regulations the full cost of the sector's implementation of a revised Charities SORP.

- 8.3.3 There are approximately 9,900 non-company charities registered with the Charity Commission that are required to prepare accounts on an accruals basis that give a true and fair view. It is further estimated that some 5,000 excepted charities are required to produce accruals accounts.
- 8.3.4 Larger charities with annual income in excess of £1m will tend to employ their own finance staff who take responsibility for the drafting of statutory accounts. It is anticipated that finance staff will address training needs through a combination of private study of the text of the revised Charities SORP and related Charity Commission literature that explains and highlights key changes and/or through attendance at seminars held by specialist audit firms, professional bodies, umbrella groups and the Charity Commission.
- 8.3.5 It is estimated that the changes proposed by the revised SORP could be assimilated in two days private study and that training courses explaining the changes are likely to be structured as half day courses. Most seminars addressing the revised SORP are likely to be made available free of charge or at low cost but for these purposes an average cost, including travel, of £125 is assumed.
- 8.3.6 Smaller charities with annual income of less than £1m will often rely to a greater extent on their auditors or independent examiners to ensure statutory accounts are prepared in accordance with the methods and principles of the Charities SORP. It is also anticipated that such charities will place greater reliance on publications summarising the changes and make greater use of pro forma accounts packages prepared by the Commission. In this way the key changes of the revised SORP can be addressed in a day's private study.
- 8.3.7 It is estimated that charities with:
1. income of over £10m would train two members of staff both attending training courses;
  2. income of between £1m and £10m would train one member of staff who would also attend a training course;
  3. income of over £100K but below £1m are likely to place reliance on their auditor or independent examiner to help ensure implementation of the revised SORP although some background reading of guidance ( 1 day) is still desirable. It is further estimated that half of such charities would send one staff member on a training course;

4. excepted from registration would adopt a similar approach as that of the £100k to £1m income band with only a quarter of such charities sending a staff member on a training course.

8.3.8 Using these assumptions and based on the following cost estimates:

Cost of half day training seminar	£125.00
Cost of Staff time per day (larger charities over £10m)	£200 per day (assuming staff pay of £50,000 per annum)
Cost of Staff time (charities £1m to £10m)	£140 per day (assuming staff pay of £35,000 per annum)
Cost of Staff time per day (less than £1m)	£100 per day (assuming staff pay of £25,000)

The following training costs arise:

Income band	Number of charities	Study days	Private study costs	Course days	Staff costs of attending course	External course costs	Total cost
Over £10m	138	552	£110,400	138	£27,600	£34,500	£172,500
£1m to £10m	1,016	2032	£284,480	508	£71,120	£127,000	£482,600
£100k to £1m	8,757	8,757	£875,700	2189	£218,900	£547,250	£1,641,850
Excepted charities	5,000	5,000	£500,000	625	£62,500	£156,250	£718,750
<b>Total</b>	<b>14,911</b>	<b>16,341</b>	<b>£1,770,580</b>	<b>3,460</b>	<b>£380,120</b>	<b>£865,000</b>	<b>£3,015,700</b>



8.3.9 The adoption of the methods and principles of the SORP will involve certain re-analysis of costs in the Statement of Financial Activities that may also result in some restatement of comparative figures. The information required for this analysis will be available from accounting records and therefore implementation costs will relate to the summarisation of such data and their insertion into the primary statements. Certain charities may also have to review accounting policies in relation to recognition principles. However, in so far as this latter change stems from developments in accounting standards and principles, such costs arise irrespective of the adoption of the methods and principles of the Charities SORP.

8.3.10 It is estimated that these aspects of implementation would involve charities with income in excess of £10m with up to three days' work, charities in the £1m to £10m in two days' work and charities below the £1m threshold in a day's work with a similar implementation cost applying to excepted charities.

8.3.11 On the basis of these estimates the following one-off implementation costs arise:

<b>Income band/category</b>	<b>Number of charities</b>	<b>Staff days</b>	<b>Total</b>
Over £10m	138	414	£82,800
£1m to £10m	1,016	2,032	£284,480
£100k to £1m	8,757	8,757	£875,700
Excepted charities	5,000	5,000	£500,000
<b>Total</b>	<b>14,911</b>	<b>16,203</b>	<b>£1,742,980</b>

### **Charities below £100,000**

8.3.12 Charities with income below £100,000 may opt to prepare their accounts on a receipts and payments basis. The accounting Regulations do not apply to accounts prepared on this basis. Therefore in so far as the Act allows charities in this band the ability to choose whether or not to prepare accounts on the accruals basis to give a true and fair view, the Regulations will impose no compliance cost.

8.3.13 Charities may choose to adopt the accruals accounting basis if that framework is best suited to their needs and would then be required to apply the methods and principles of the Charities SORP. Many charities do prefer to prepare accounts to give a "true and fair view" as required of accruals accounts. Charities within this category who prepare accruals accounts tend to rely on trustees or volunteers with knowledge of accounting or place reliance on their auditors or examiners to provide an accounts preparation service. The training costs involved for auditors and examiners is considered in the following section. The Charity Commission also produces pro forma accounts

packs for such charities who wish to prepare their own accounts on an accruals basis.

## Audit and examination

8.3.14 Auditors undertaking assignments in any sector where a SORP applies require a reasonable understanding of the recommendations of any applicable SORP. This presumption of reasonable understanding would apply equally to charity auditors. In so far as auditors of charities that are companies would need to acquire such requisite skills to undertake their audit, the adoption of the methods and principles of the SORP for non-company charities would only have a marginal impact on their training needs where such firms act for both company and non - company charities.

8.3.15 For illustrative purposes, we include an estimate of the one-off training costs for accountancy firms and businesses. Some firms may absorb these costs as an internal training overhead, other may pass on these costs in whole or in part to their charity clients.

8.3.16 We estimate that as many as 1,000 audit partners may have charity audit clients with income in excess of £100,000. Such partners will primarily acquire such knowledge through private study although larger firms with specialist charity sections may provide specialist training staff as part of their programmes for ongoing professional development. The changes to the Charities SORP can be assimilated in two days' private study by those requiring expert knowledge and in one day by those requiring reasonable knowledge. We estimate that up to 1,000 partners and 2,000 staff would avail themselves of such study. On the assumption of a charity audit partner's pay being £100,000 and staff pay of £35,000 the following costs arise:

Staff level	Number	Days	Cost per day	Total cost
Partners (2 day's study)	500	1,000	£ 400	£400,000
Partners (1 days study)	500	500	£ 400	£200,000
Staff (1 day study)	2000	2000	£140	£280,000
<b>Total</b>	<b>3000</b>	<b>3,500</b>		<b>£880,000</b>

(These above costs are included for illustrative purposes only as auditors of charitable company would need to acquire reasonable knowledge to undertake their duties in the absence of Regulations)

8.3.17 Some of these audit partners will also undertake independent examinations but in addition to this many individuals also undertake independent examination assignments. We estimate that as many as 1,000 individuals may undertake such work for charities preparing accruals accounts, some on a voluntary basis. As such individuals

would not normally be involved in charity audits, a cost exists for such individual to become acquainted with the changes to the Charities SORP. We anticipate such knowledge would again be gained from private study. We anticipate a full day's private study being necessary to assimilate the changes. An estimated lost opportunity cost of £25,000 has been assumed for independent examiners. Many independent examiners would acquire their skills through their involvement as staff of other charities or as staff members of audit firms that undertake charity work. These cost savings have been ignored in the calculations.

<b>Number of Examiners</b>	<b>Study days</b>	<b>Cost per day</b>	<b>Total cost</b>
1,000	1,000	£100	£100,000

### **Trustees' annual report**

8.3.18 The annual report Regulations do not directly adopt the recommendations of the Charities SORP but rather set out the information to be contained in the review of activities and the information to be provided relating to the charity, its trustees and officers. The Charities SORP expands on these requirements as a matter of recommended practice. The annual report Regulations also apply to companies that are charities and therefore the cost of compliance includes those costs that will arise in the context of charitable companies.

8.3.19 The changes proposed by the new Regulations to the content of the annual report apply primarily to auditable charities. The most significant change to the annual report is in the way in which auditable charities are required to report their activities, in particular, reporting their achievements by reference to the aims and objectives set by charity. The Regulations do not require a charity to adopt any particular approach or methodology in setting objectives or impose any particular methods for the reporting of achievements measured against those objectives.

8.3.20 The existing Regulations already require that a charity should report its achievement in relation to its objects and therefore procedures are likely to exist for the collection and collation of relevant information for existing reporting purposes. The new Regulations do however create a potentially new compliance cost in that achievement is measured by reference to the objective set by the charity. This will result in a different emphasis in how information is presented and will therefore give rise to a one-off compliance cost on implementation.

8.3.21 The additional disclosures relating to any ethical considerations are taken into account in setting investment policies and should not involve

additional information collation costs. The disclosure of the procedures adopted for trustees' induction and training are also unlikely to create any significant increase in the information collated for the preparation of the report. Similarly, enabling the disclosure of social and programme related investment policies as part of grant making policies is unlikely to create a need to collate new information. In relation to reserves policies, identifying the amount of designated funds excluded from the income reserves calculation creates no additional information costs as designations will usually be provided within the financial disclosures of the accounts. The implementation costs of these disclosures are therefore not considered to be significant.

8.3.22 The Charity Commission has changed its policy in relation to CIFs, other than pooling schemes, requiring them to have governance arrangements similar to authorised unit trusts. These changes mean that amendments are needed to disclosures provided in the annual report and reporting responsibilities.

8.3.23 The costs of implementing the changes to the annual report are likely to vary according to the size and complexity of the charity. It is also assumed that the salary costs of staff involved in this work will reflect these differing levels of complexity. The restructuring of existing information and its presentation in line with this new reporting focus could take between as little as an hour in a single objective charity to several days in a particularly complex charity. For the purposes of these calculations it is assumed that two days' work is involved in charities with income over £10m, and a day for charities between £1m and £10m and a half day in charities with income less than £1m.

8.3.24 Using these assumptions and based on the following cost estimates:

Cost of Staff time per day (larger charities over £10m)	£120 per day (assuming staff pay of £30,000 per annum)
Cost of Staff time per day (charities £1m to 10m)	£100 per day (assuming staff pay of £25,000 per annum)
Cost of Staff time per day (less than £1m)	£80 per day (assuming staff pay of £20,000)

The following one-off implementation costs arise:

<b>Income band</b>	<b>Non-Company charities</b>	<b>Company Charities</b>	<b>Days</b>	<b>Cost per day</b>	<b>Total Cost</b>
Over £10m	138	365	1,006	£120	£120,720
£1m to £10m	1,016	2,985	4,001	£100	£400,100
£250k to £1m	3,047	4,646	3,846	£80	£307,680
<b>Total</b>	<b>4,201</b>	<b>7,996</b>	<b>8,853</b>		<b>520,820</b>

## 8.4 Cost Summary

### Option 1: Retain the 1995 and 2000 Regulations

8.4.1 The failure to issue new Regulations would impede the issue of a revised Charities SORP and result in each individual charity interpreting UK GAAP for its own accounts preparation purposes. Estimated cost: £3,390,780.

8.4.2 No benefits are identified under this option.

### Option 2: Implement the Regulations

1.1.1. Compliance costs summary:

One-off cost to charities of staff training	£3,015,700
One-off costs to charities of implementing accounting “methods and principles”	£1,742,980
One-off costs to charities of implementing annual reporting requirements	£520,820
<b>Total sector costs</b>	<b>£5,279,500</b>
Total annual income of registered charities affected by Regulations (excluding excepted charities)	£31,909,212,116
Sector costs as percentage of sector income *	0.016 per cent
One - off training costs for auditors	£880,000
One - off training costs for independent examiners	£100,000
Total costs to auditors and examiners	£980,000

<b>Total compliance costs</b>	<b>£6,259,500</b>
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\* This percentage would decline further if the income of excepted charities were included.

## **8.5 Other costs**

8.5.1 There are not anticipated to be any other costs.

## **8.6 Costs for a typical charity**

8.6.1 A typical registered non-company charity of the size affected by the Regulations that is subject to both the accounting and reporting Regulations will, we estimate, face a one-off implementation cost of £360.

## **9. Consultation with small business: the Small Firms' Impact Test**

9.1 The small Business Service has confirmed that it not thought that the Regulations will have a significant effect on small businesses.

## **10. Competition Assessment**

10.1 The competition filter test indicates that the proposed regulations give no competition concerns.

## **11. Enforcement and sanctions**

11.1 The proposed Regulations will, if necessary, be enforced under existing provisions of the Charities Act and will result in no additional enforcement costs.

## **12. Monitoring and review**

12.1 The legislation will be monitored on an ongoing basis by the Charity Commission who receive annual reports and accounts from all registered charities with income of over £10,000 per annum. A full review of the regulations will take place in 5 years, or earlier if there are found to be causes for concern.

## **13. Consultation**

## **1.1. Within government**

- 1.2. The Home Office have consulted with the Charity Commission, Department of Trade and Industry and HM Treasury on this matter.

## **1.3. Public consultation**

- 1.3.1. The Regulations were exposed to public consultation between 24 November 2004 and 18 February 2005. The consultation was circulated to 258 organisations that included a range of charities, key umbrella groups, charity auditors and professional bodies with interests in accounting and reporting requirements. In addition the consultation was published on the Home Office web site and highlighted by the Charity Commission in the "Sector News" section of their web site. Responses were received from 29 organisations or individuals.
- 1.3.2. The Charity Commission undertook a separate consultation in relation to proposals to issue a revised Charities SORP applicable to charities for accounting periods commencing on or after 1 April 2005. This consultation closed on 1 October 2004 and the Accounting Standards Board issued their certificate on the revised Charities SORP on 28 February 2005.
- 1.3.3. Of the 29 responses received 22 were considered supportive of both the need for regulations and the direction proposed. A number of respondents gave their general support but chose not to answer all or some of the specific questions raised by the consultation. Of the remaining seven responses, three responses focused on single issues and did not provide a general indication of their support or otherwise. One respondent raised concerns as to the applicability of the provisions to grant making charities. Only three respondents were clearly not supportive, one of these suggested the result would be greater conformity rather than greater transparent and two other respondents felt the Regulations and indeed to SORP were not well suited to the needs of Army Service Non Public Fund charities.

## **2. Summary and recommendation**

- 2.1. Our clear preference is for option 2. It best meets the objective of providing an accounting and reporting framework relevant to charities' reporting needs and creating appropriate accountability to charities' stakeholders and the wider public for the resources they control. It provides a framework that is consistent with UK GAAP, prevents a fragmentation of the charity accounting regime and takes forward key Strategy Unit Review recommendations.
- 2.2. Although significant one-off implementation costs to the charity sector arise, estimated at £ 5.3m, these are necessary to maintain the

relevance of the regulatory framework. Implementation of the Regulations avoids each individual charity developing its own approach and interpretation of UK which would give rise to an estimated cost of £ 3.4m. It is anticipated that the benefits achieved in terms of consistency and comparability in financial reporting will outweigh the potential costs of implementation.

- 2.3. Unquantifiable indirect benefits may also accrue to the charity sector though the creation of a reporting framework more clearly focused on reporting a charity's performance. The contribution such reporting makes to the efficiency and effectiveness of the sector is impossible to gauge. However, if the sector's effectiveness improved by only a tenth of one percent (0.1) of the income (£31.9 bn) of those charities affected this would result in benefits of £31.9 m.

## 1. Declaration

***I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.***

***Signed .....***

***Date***

***Fiona Mactaggart, Parliamentary Under Secretary for Race Equality, Community Policy, and Civil Renewal, Home Office***

## 2. Contact point

- 2.1. Enquiries regarding the contents of this consultation document should be made to:

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**CHARITIES  
(ACCOUNTS AND REPORTS)  
REGULATIONS 2005**

**REGULATORY IMPACT ASSESSMENT**

**FOR**

**INVESTMENT FUND CHARITIES**

**MARCH 2005**

## **1. Title of proposal**

- 1.1. Regulations relating to the accounting and reporting requirements of Investment Fund Charities (including Common investment Funds (CIFs) and Common Deposit Funds (CDFs)) which will be part of the Charities (Accounts and Reports) Regulations 2005 made under the Charities Act 1993.

## **2. Purpose and intended effect of measure**

### **2.1. The objective**

- 2.1.1 The requirements will amend the relevant parts of the Charities (Accounts and Reports) Regulations 1995 (the 1995 Regulations) to:
  - 2.1.1.1 address certain changes to the governance and regulatory framework in which certain CIFs operate; and
  - 2.1.1.2 create consistency of reporting requirements with the Investment Management Association's Statement of Recommended Accounting Practice (SORP) for the Financial Statements of Authorised Funds published in November 2003.

### **2.2. Devolution**

- 2.2.1. The Regulations affect charities in England and Wales only.

### **2.3. The background**

- 2.3.1. The 1995 Regulations included accounting provisions relating to CIFs which were consistent with the SORP for Authorised Unit Trust Schemes published by the Investment Management Regulatory Organisation in April 1991 and also set out information to be provided in the annual reports of such charities. Two changes have occurred which makes these provisions out of date:
  - The Charity Commission has changed its policy in relation to CIFs, other than pooling schemes, requiring them to have governance arrangements similar to authorised unit trusts. These changes mean that amendments are needed to disclosures provided in the annual report and reporting responsibilities.
  - The SORP for Authorised Unit Trust Schemes has been superseded and the Regulations require certain amendments to ensure consistency with the requirements placed on authorised unit trusts and open-ended investment companies by the Statement of Recommended Practice for the Financial Statements of Authorised Funds published by the Investment Manager Association in November 2003.

## **2.4. Risk assessment**

- 2.4.1. The risk of not revising the Regulations is that the regulatory framework is out of step with developments in governance now generally adopted by CIFs. In particular, new schemes adopted by CIFs no longer confer the whole administrative responsibility on a body of individual trustees but allocate responsibilities between a professional fund manager and a professional or corporate trustee with some schemes also providing for an advisory board. Without amendment the Regulations would fail to recognise these new governance structures and the reporting responsibilities they entail.
- 2.4.2. The accounting framework provided by the Regulations would be inconsistent with recommended practice adopted by authorised funds and in particular would continue to apply the valuation bases provided by a superseded SORP.

## **3. Options**

### **3.1. Option 1: Retain the 1995 Regulations**

- 3.1.1. This option would result in maintaining an annual reporting framework that fails to recognise the governance and reporting structure now adopted by the majority of Commercial CIFs. The accounting methods and principles for valuing fund assets and liabilities would seek compliance with a superseded SORP.

### **3.2. Option 2: Implement the new Regulations**

## **4. Benefits**

### **4.1. Option 1: Retain the 1995 Regulations**

- 4.1.1. This option would not provide any benefits.

### **4.2. Option 2: Implement the new Regulations**

- 4.2.1. The changes in the regulations will:

- 4.2.1.1. allow investment fund charities to prepare reports and accounts using methods and principles consistent with the Investment Management Association's SORP; and
- 4.2.1.2. ensure reporting responsibilities and information provided with the annual report reflects the governance arrangement currently adopted.

## **5. Business sectors affected**

- 5.1. The proposed changes affect some thirty-eight CIFs of which eight are “hybrid” schemes which limit participation to charities that are connected to the body of trustees that administer the investment fund. Of these some twenty-nine CIFs have adopted new governance arrangements along the lines of those applying to authorised unit trusts. Currently there is only one CDF affected by the proposed changes. Most investment fund charities are administered by professional fund managers. The impact on their reporting requirements would be limited to when they report as trustee of such funds.

## **6. Race impact assessment**

- 6.1. It is not considered that the proposed changes will bring disproportionate benefits or costs to any particular groups. Research conducted by the Council for Ethnic Minority Organisations (CEMVO) suggests that the majority of BME organisations are small, with an income of less than £10,000, and so would not be affected by the proposed Regulations. A review by the Charity Commission of the CIFs affected by the proposed Regulations did not identify any of these investment fund charities as being connected with BME organisations.

## **7. Sustainable development**

- 7.1. Consideration has been given to whether these proposals will have costs or provide benefits to environmental protection, social values and progress, or the economy’s long term growth and development. The proposals would not lead to any disproportionate adverse impact.

## **8. Costs**

### **8.1. Compliance costs**

- 8.1.1. There will be only marginal change to compliance costs for the small number of charities concerned.

### **8.2. Option 1: Retain the 1995 Regulations**

- 8.2.1. If the Regulations are not changed certain indirect compliance costs may be incurred by investment fund charities as a result of producing annual reports that seek to address new governance structures without a framework for such reporting being provided by the Regulations. Similar costs might also arise in seeking to comply with the valuation methods and principles of a superseded SORP.

### **8.3. Option 2: Implement the new Regulations**

- 8.3.1. The proposed changes impact primarily on those investment fund charities that have adopted new governance arrangements which allocate the responsibilities for operating the fund between a professional fund manager and a professional or corporate trustee. These changes in governance arrangement are reflected in the reallocation of responsibilities for preparation of accounts and annual reports and do not give rise to additional compliance costs.
- 8.3.2. A number of changes are proposed to the information provided within the Trustees Annual Report including an explanation of the objectives of the fund and details of whether persons conducting regulated activities hold relevant authorisation. These proposed changes are unlikely to create any significant compliance costs.
- 8.3.3. The key change proposed to the accounting requirements is for the methods and principles contained within the Statement of Recommended Practice for the Financial Statements of Authorised Funds to be applied in valuing fund assets and liabilities. These methods and principles are consistent with the superseded Statement of Recommended Practice for Authorised Unit Trust Scheme adopted by the 1995 Regulations and therefore no significant compliance costs are anticipated as a result of this change.
- 8.3.4. The minor changes to form and content of investment fund accounts including the introduction of a more relevant analysis of expenditure incurred in the administration of the funds and the balance sheet disclosure of reserves held by CDFs reflect current reporting practice and again are unlikely to result in any significant increase in compliance costs.
- 8.3.5. It is recognised that those charged with the administration of such investment funds will incur some one-off time costs in acquainting themselves with the proposed Regulations. Achieving compliance with the Investment Management Association's SORP creates little regulatory costs due to the consistency with the superseded SORP. Fund managers have experience in applying the requirements of the Investment Management Association's SORP and therefore no training costs will be involved.
- 8.3.6. These changes are unlikely to necessitate a need for training costs either for the auditors of such investment funds or those charged with their administration. No significant changes to record keeping or accounting procedures are anticipated.
- 8.3.7. It is estimated at the changes proposed can be assimilated and applied with a time cost for an individual charity of no more than a day. Assuming an annual salary cost of £50,000 for those involved in such work a daily cost of £200 is assumed. There are thirty-eight charities affected by the proposed changes giving rise to a total one-off compliance cost of £7,600.

#### **8.4. Other costs**

8.4.1. There are not anticipated to be any other costs.

## **8.5. Costs for a typical business**

8.5.1. A typical investment fund charity will see no significant increase in the cost of preparation of its annual reports and accounts. Certain one-off costs will arise primarily from assimilating the changes arising from the new Regulations. These one-off costs are estimated at £200.

## **9. Consultation with small business: the Small Firms' Impact Test**

9.1. The Small Business Service has confirmed that it is not thought that the Regulations will have a significant impact on small businesses.

## **10. Competition Assessment**

10.1. The competition filter test indicates that the proposed regulations give no competition concerns.

## **11. Enforcement and sanctions**

11.1. The Regulations will, if necessary, be enforced under existing provisions of the Charities Act 1993 and will result in no additional enforcement costs.

## **12. Monitoring and review**

12.1. The legislation will be monitored on an ongoing basis by the Charity Commission who receive annual reports and accounts from all charities with income of over £10,000 per annum. A full review of the Regulations will take place in 5 years or earlier if there are found to be causes for concern.

## **13. Consultation**

### **13.1. Within government**

13.1.1. The Home Office has consulted with the Charity Commission on this matter together with the Department for Trade and Industry and HM Treasury. The Financial Services Authority has also been consulted.

### **13.2. Public consultation**

13.2.1. The Regulations were exposed to public consultation between 24 November 2004 and 18 February 2005. The consultation was circulated to 129 organisations and individuals including the fund managers, trustees and auditors of all "commercial" CIFs, a sample of charities that operate "pooling scheme" or "hybrid" CIF arrangements. In addition key charity sector umbrella bodies and professional bodies were included. The

consultation was also published on the Home Office web site and highlighted by the Charity Commission in the “Sector News” section of their web site. Responses were received from nine organisations. Two of these responses received were from fund managers each of whom act for a number of “commercial” CIFs.

13.2.2. The proposed amendments to the Regulations as far as they affect investment fund charities were not considered likely to raise significant issues as the amendments simply reflected those necessary to bring them in line with accounting and reporting practices already widely adopted by such charities. Of the nine responses received eight were considered supportive of both the need for regulations and the direction proposed.

## **14. Summary and recommendation**

14.1. Our clear preference is for option 2. It best meets the objective of providing an accounting and reporting framework relevant to charities’ reporting needs and creating appropriate accountability to a charity’s stakeholders for the resources they control. The proposed Regulations are necessary to maintain a regulatory framework that is in line with current governance and reporting requirements.

## **15. Declaration**

***I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.***

***Signed*** .....

***Date***

***Fiona Mactaggart, Parliamentary Undersecretary for Race Equality,  
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## **16. Contact point**

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