CHARITY COMMISSION

Mr Rufus Rottenberg
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Your Ref:
Our Ref:

Date: 16 December 2011

Dear Mr Rottenberg,

Audit Exemptions and Change of Accounting Framework

The Charity Commission for England and Wales is established by law as the regulator and registrar of charities in England and Wales. Our aim is to provide the best possible regulation of these charities in order to increase charities' efficiency and effectiveness and public confidence and trust in them.

We welcome the opportunity to respond to your consultation on the future of narrative reporting. There are approximately 29,000 company charities on our register of charities which represents 17% of all registered charities. Our response to your consultation (see annex) addresses only those questions that may impact on charities and their trading subsidiaries and no comment is offered on matters which are unlikely to have a direct bearing on company charities and their trading subsidiaries.

We understand from your consultation that these proposals will not impact on any audit requirements under the Charities Act 1993 that may also apply to companies that are charities and have claimed exemption from audit under the Companies Act. We welcome this approach.

We would also point out that a parent company charity could only guarantee the debts, commitments or liabilities of a subsidiary if it was in furtherance of the charity's charitable objects. The parent company's charitable funds must be applied for the charity's purposes in accordance with its objects. We would suggest that guidance will be needed to ensure that directors of company charities understand the limited circumstances in which a guarantee could be offered.

If I can be of any further assistance please do contact me.

Yours sincerely,

Nigel Davies. Deputy Head of Accountancy Policy

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Annex to Charity Commission response:
Consultation on audit exemptions and change of accounting framework

Response to selected consultation questions

Question 1. What are your views on the overall principle of reducing audit requirements for unlisted companies?

We recognise that the needs for unlisted private companies for accountability to investors, who may often be closely involved in the management of the company, differ from those of donors and financial supporters of charities. The legal framework in which charities operate is different with even small charities having a duty of accountability to those who donate to them.

We also recognise that if the debts or a subsidiary are guaranteed then the information needs of its creditors and the reporting assurances they seek may be reduced.

We note that paragraph 70 of your consultation states 'these proposals will not affect the audit thresholds for charities, since these were last changed comparatively recently in 2008'. We assume this means that these proposals will not impact on any audit requirements under the Charities Act 1993 that may also apply to companies that are charities and have claimed exemption from audit under the Companies Act.

If this understanding is correct then the proposals have limited application to company charities because even if they were exempt from audit under Companies Act requirements, an audit may then still be required under the Charities Act 1993. A company that is a charity and not audited under Companies Act provisions is subject to an audit under the Charities Act 1993 if its gross income exceeds £500,000 or its balance sheet total exceeds £3.26m and it gross income exceeds £250,000.

You should be aware that the Minister for the Cabinet Office appointed Lord Hodgson of Astley Abbotts to undertake a review of the Charities Act 2006. The terms of reference for this review indicate that it will include consideration of the accountability of the charity sector including relevant accounting and audit thresholds. Whilst your proposals do not appear to impact on the requirements of the Charities Act, they do introduce a staff number threshold for audit into the Companies Act that does not exist under Charities Act requirements. However, any need for consistency between the two requirements could be considered in the context of Lord Hodgson's review.

Question 3. Do you agree that the audit and accounting exemption for small companies should be aligned and a small company should be able to obtain the audit exemption if it meets two out of the three criteria?

This proposal is sensible and pragmatic; however this change will have only a limited application for company charities. Company charities that become exempt from a Companies Act audit as a result of this proposal would still require an audit under the Charities Act 1993 if either the asset or income thresholds of that Act were exceeded.

Annex to Charity Commission response:
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In the context of charitable companies, you may also wish to consider a definitional issue that arises when applying the proposed financial thresholds. The definition of turnover in company law excludes certain income sources commonly received by charities from voluntary sources such as gifts, donations, grants and legacies. These income sources do not count towards turnover are they are not derived from the contractual supply of goods and services. As a result, a charity with an income in excess of £6.5 million could still qualify as a small company if its income was in whole or partly derived from voluntary sources despite exceeding either the balance sheet total or staff number threshold.

This might be seen as anomalous and, if so, an argument exists to replace for company charities the turnover threshold with a gross income threshold. Gross income might, for example, be defined as: income and gains from all sources including special trusts but excluding the income or gains of any endowment fund administered by the charity.

Question 5. Under Option C, what would be the effect of exempting qualifying non-dormant subsidiaries from mandatory preparation of accounts, mandatory filing of accounts and mandatory audit of accounts?

Charities frequently carry out fundraising and non-charitable trading activities through wholly owned trading subsidiaries. Charities may also undertake charitable activities through wholly owned companies.

However, a parent company charity could not normally guarantee the debts, commitments or liabilities of a non-charitable subsidiary because the parent company's charitable funds must be applied for the charity's purposes in accordance with its charitable objects. We therefore see these proposals as being of limited application to company charities. The directors of a parent charity can offer a guarantee when to do so would further the parent's charitable objects.

It may be appropriate for a parent charity in certain circumstances to offer a guarantee, for example when the subsidiary undertakes a project on behalf of the charity which falls within the charity's own objects. Whilst we recognise that it may not be appropriate to deal with this issue by seeking to exclude charities from the proposal, there will be a need for guidance on the circumstances in which a company charity may guarantee the debts of its subsidiary.

It is important that parent company charities do not use their charitable funds to inappropriately guarantee the debts of their non-charitable subsidiary companies. The audit exemption proposals could inadvertently create a perverse incentive so to do. This risk could be addressed through guidance.

It would be helpful if BIS, in developing any guidance or commentary it produces, could refer company charities to our website for further guidance on offering such guarantees. We would aim to produce that guidance in due course.

However, we do not concur with the proposal of relieving qualifying subsidiaries from the duty to prepare annual accounts. It seems to us that all the accounting information and disclosures necessary to prepare accounts would need to be collated and scheduled in order to prepare the consolidated accounts that meet statutory requirements. Moreover, this information would need to be prepared and scheduled in accordance with the requirements of accounting standards where the subsidiary is material in the context of the group accounts. Therefore, we question whether the cost saving will be significant and are doubtful whether any savings would outweigh the loss of public information that may have relevance beyond giving assurance to the entity's creditors.

Question 18. Do you agree that the guarantee should be irrevocable and in respect of all debts in respect of that financial year? Until an audited set of accounts for the subsidiary is filed it will also be in respect of future debts incurred by the subsidiary.

As explain in our response to question 5, a parent company charity could not normally guarantee the debts, commitments or liabilities of a non-charitable subsidiary as the parent company's charitable funds must be applied for the charity's purposes in accordance with its objects.

Question 19. Do you agree that the guarantee should cover the 'debts' of the subsidiary and not extend to its 'liabilities'?

As we explain in our response to question 5, a parent company charity could not normally guarantee the debts, commitments or liabilities of a non-charitable subsidiary as the parent company's charitable funds must be applied for the charity's purposes in accordance with its objects.

Question 20A. Do you agree with the proposals for the Guarantee?

As we explain in our response to question 5, a parent company charity could not normally guarantee the debts, commitments or liabilities of a non-charitable subsidiary as the parent company's charitable funds must be applied for the charity's purposes in accordance with its objects. In our view guidance is needed for company charities to ensure that any guarantee offered is solely in furtherance of their charitable objects.