

NOT FOR PROFIT HOW TO GUIDES

Independent Examination vs. Audit

This fact sheet is intended for charities registered only in England & Wales. There are different scrutiny requirements for charities registered in Northern Ireland and in Scotland. Those charities registered in more than one jurisdiction need to fulfil the requirements of the most onerous regime.

Options

Independent examinations and audits are both forms of “external scrutiny”. All charities in England and Wales who have income over £25,000 are required to have a form of external scrutiny.

The primary objective is to maintain transparency and public confidence in the work of charities and the use of their resources.

The thresholds for the type of external scrutiny required were last amended in February 2015, the government announced the results of its consultation on charity audit thresholds and related matters.

Its proposals were enacted via the Charities Act 2011 (Accounts and Audit) Order 2015, resulting in revised thresholds as follows:

- The income threshold for charity audit increased from £500,000 to £1 million therefore giving more charities the option of having an independent examination as opposed to a statutory audit;
- The aggregate group income threshold at which parent charities should have group accounts audited was raised from £500,000 to £1 million in order to align it with the income threshold for individual charities;
- The threshold for the preparation of group accounts was raised from £500,000 to £1 million; and
- The asset threshold remains unchanged (an audit is still required where the charity’s assets are worth more than £3.26 million and it has income of more than £250,000). Although there was broad support for increasing one or both of these thresholds, in practice it is difficult for the government to do so at present given the way charity and other legislation is currently drafted.
- These changes were implemented with effect for charities with a period end ending on or after 31 March 2015.

Important points to note

It is important to re-iterate that there may be many cases where a charity is not required by statute to have its accounts audited but may still choose to do so because, for example:

- There is a (current) requirement in its governing document – although note that this may be able to be amended if desired;
- Certain funders require the statutory accounts to be subject to audit; and / or
- The charity chooses to have an audit as a means of providing additional assurance to its various stakeholders, and to take advantage of the benefits and by-products of a well-planned and executed audit.

It is acknowledged that the proposed measures will create a discrepancy between audit thresholds for charities in different parts of the UK – an unavoidable situation given that charity law is devolved in Scotland and Northern Ireland. It is important to note that charities need to comply with the audit requirements in their particular jurisdiction.

Relative merits: Independent examination vs. audit

These are best set out in the table overleaf, as the merits of one approach often reflect the relative downside of the other approach, and vice versa. In our experience, even charities which can opt for an independent examination often prefer to have an audit due to the increased assurance provided from the audit process.

This is particularly the case where the charity has a range of existing and potential stakeholders, is active in a wider community and relies on its good reputation and profile to maintain / increase funding from funders, or the public. Some trustees consider that subjecting the charity to an audit also helps them to demonstrate their charity's – and their own - accountability and transparency, especially to existing and potential funders, donors and beneficiaries.

Whilst an audit can place more demands on charity staff time, staff often welcome the opportunity to have their work independently verified as it affords them a level of "protection" - particularly if there are only one or two individuals responsible for the accounting process. Trustees also welcome the opportunity for the charity's systems and processes to be independently reviewed, with opportunities to learn more about wider best practice.

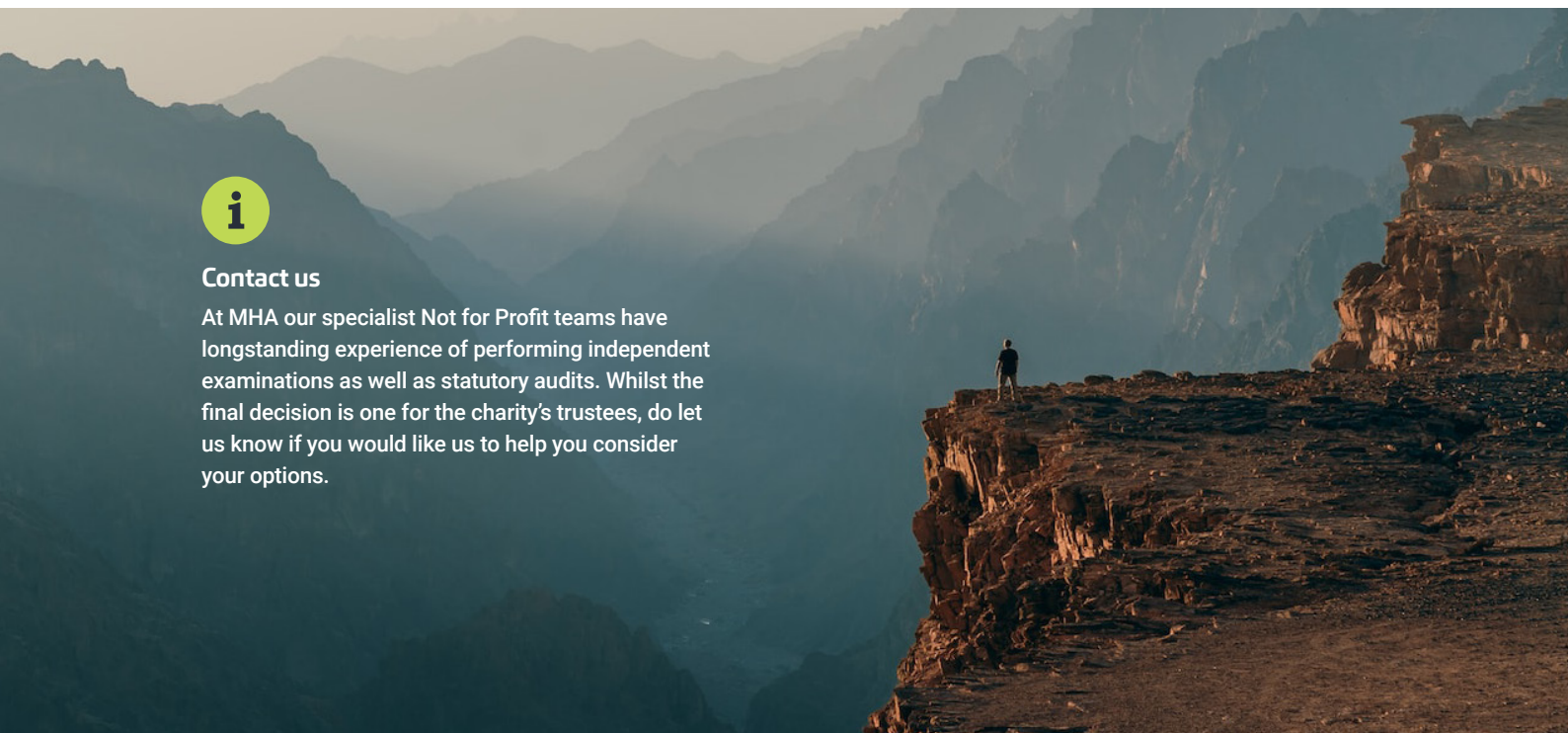
Where charities are actively looking for new sources of funding, the provision of audited accounts is often an advantage – if not a necessity. Some funders specifically require audited accounts; others are still not sure of the status of an independent examination and may view it with a certain element of suspicion.

Where charities decide to opt for an independent examination, however, it will almost undoubtedly be cheaper – a key factor in ensuring that as many of the charity's resources as possible are directed to charitable activities.



Contact us

At MHA our specialist Not for Profit teams have longstanding experience of performing independent examinations as well as statutory audits. Whilst the final decision is one for the charity's trustees, do let us know if you would like us to help you consider your options.



Independent examination

Statutory audit

Merits	Downside
Simpler process – in essence it comprises a review of the accounting records kept by the charity and a comparison of the accounts to those records. Should be undertaken in accordance with the Charity Commission's "Directions".	More onerous form of external scrutiny than an independent examination requiring more auditor input, and management time. Has to be undertaken in accordance with International Standards on Auditing (ISAs) supplemented by relevant specialist guidance for charity auditors.
The examination provides trustees, funders, beneficiaries, stakeholders and the public with a form of confirmation that the accounts of the charity have been reviewed by an independent person.	
Less expensive than an audit.	Costs more than an independent examination.
Downside	Merits
Less depth to the work i.e. less vouching of the validity of entries and items as the examiner's work is primarily based around checking the extraction of underlying data into the accounts, and analytical review. Verification and vouching will only occur in exceptional cases.	Audit work is governed by ISAs which require more rigour, including testing (on a sample basis) the validity of items, completeness, cut off, existence of assets etc. For example, verifying bank balances to independent bank letters; property entries to land registry records / valuation reports.
The examiner's report to the trustees is only required to confirm that no evidence has been found that suggests that the accounts have not been prepared properly. It is "negative assurance" therefore providing a more limited form of scrutiny. Certain matters will be reported where there are significant concerns.	The auditor provides a positive statement on whether the accounts show a "true and fair view" (i.e. based on whether they contain any "material" errors / omissions).
The opinion is not providing assurance as to whether the accounts show a "true and fair" view.	The auditor has to build up a body of evidence to support a positive opinion on the accounts; therefore the audit opinion provides more assurance – thus giving more "comfort" to trustees, staff, funders, donors, beneficiaries and other stakeholders.
No requirement to review internal financial (and other) controls and systems; no requirement to plan work and review systems from the perspective of prevention / detection of fraud and error although the examiner will report any issues s/he comes across in this area.	Requirement to review and test internal financial controls and systems. As well as providing more assurance, this can lead to helpful recommendations in the management letter.
No requirement to produce a management letter.	Useful end product is a constructive management letter for trustees (agreed with management). This is a helpful way of highlighting recommendations for systems improvements, sharing of best practice and flagging relevant upcoming sector / regulatory developments to management and trustees.

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