

15 July 2024



Scottish Government

Review of charity regulation

Response from ICAS

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Introduction

The ICAS Charities Panel submitted comments to the Scottish Government on its *Review of charity regulation* consultation. Our comments were submitted to the Scottish Government online and are replicated below under the heading 'Responses to specific consultation questions'.

Responses to specific consultation questions

Question 1

Should there be a review of charity regulation?

- Yes
- No
- Don't know

Question 2

Please explain why you think there should or should not be a review of charity regulation.

Response

ICAS participated in the consultation and parliamentary process in the lead up to the Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) and we have continued to contribute to the evolution of charity law and regulation since that time.

In addition to having a keen interest in the establishment of a Scottish charity regulator under the 2005 Act, we had a particular interest in the establishment of a statutory duty and discretionary right for auditors and independent examiners to report to the regulator and the establishment of Scottish charity accounting regulations, the Charities Accounts (Scotland) Regulations 2006.

While we welcome the changes to the 2005 Act brought about by the Charities (Regulation and Administration) (Scotland) Act 2023 (the 2023 Act), we believe that a more comprehensive review is required building on the recent more limited review that led to the 2023 Act which focused on OSCR's powers.

Charities are operating in a world which has changed significantly in the past 20 years and the pace of change is only expected to increase. Therefore, we believe that the proposed review of charity regulation should be forward-looking. The review should consider what changes are needed to ensure that charity regulation will be effective in meeting the future needs of the charity sector, service users and beneficiaries; and in maintaining public trust and confidence in the sector.

However, as there has been no full post-implementation review of the 2005 Act, it will be necessary for this review to consider the effectiveness and impact of Act on the regulation of charities since it came into effect in order to inform and shape future reforms.

We believe that consideration should also be given to reviewing regulations made under the 2005 Act, including the Scottish charity accounting regulations where there are outstanding matters which require addressing.

We comment on the need to review the Scottish charity accounting regulations and other matters in our responses to questions 7 and 10.

Question 3

If a review of charity regulation is undertaken, which of the following should be the purpose of the review (choose one):

- To assess the effectiveness of current charity regulation in meeting the future needs of the sector
- To review the Charities and Trustee Investment (Scotland) Act 2005 - exploring if the Act is doing what it set out to do and if any changes are required
- Don't know
- Other – please specify

Please give us your views.

Response

For a review of charity regulation to be meaningful, it needs to be forward-looking and should consider the future needs of the sector with the needs of service users and beneficiaries and the needs of future service users and beneficiaries at the forefront. Any reforms should also be designed with the vital overarching aim of maintaining public trust and confidence in the charity sector.

We do not, however, envisage that such a review would be as effective without encompassing a comprehensive review of the 2005 Act. As referred to in our response to question 2, the 2005 Act has not undergone a full post-implementation review since the provisions of the Act came into force.

Question 4

Do you think you or your organisation will have capacity to contribute views to a review process in the next 12 months?

- Yes
- No
- Don't know

Questions on the parameters for a review

Question 5

If a review of charity regulation is conducted, what topics should it cover and why?

Response

In our response to question 2, we highlight the importance of having a forward-looking review of charity regulation, in part, informed by reflecting on the effectiveness of the 2005 Act in improving the regulation of charities. This is the context in which we set out our views on aspects of the 2005 Act and related regulations we believe should fall within the scope of the review.

We are supportive of the inclusion of the fundamental tenets of the 2005 Act within the scope of the review, for example, the charity test (both the charitable purposes and the public benefit test) and charity trustee duties.

We would also like to highlight the following matters we would specifically like to see covered in the review:

Powers of the Court of Session, Section 35 of the 2005 Act on Transfer schemes

The Scottish Ministers have the power to issue regulations under Section 35 but have not done so to date. The Scottish Government consulted on proposed regulations in 2011-12 and, following this consultation, no regulations were laid before the Scottish Parliament. ICAS responded to this consultation, raising significant questions about the potential robustness of asset transfer schemes designed by OSCR for approval by the Court of Session. We believe it is appropriate to consider whether there remains a need for OSCR designed asset transfer schemes and therefore whether there is a need for Scottish Ministers to continue to have the power to issue related regulations.

Scottish charity accounting regulations 2006: external scrutiny requirements

While there are technical issues which need to be resolved to improve the quality of the accounting regulations, there is a wider policy issue we believe should be considered. We believe it is essential to include a review of the external scrutiny requirements placed on charities, beyond consideration of the income criterion which forms part of the audit threshold. Such a review should include whether the current external scrutiny regime is proportionate. We include further commentary on this matter in our response to question 10.

Possible change to section 66 of the Act on Charity trustee duties

Earlier this year, OSCR ceased its notifiable events regime. Under this regime, OSCR required charity trustees to report details of events which have happened or are happening at their own charity which have a significant impact on the charity or its assets and beneficiaries. From April 2024, charity trustees are instead required to notify OSCR of such events by completing a 'Raise a concern form'.

This form is the means by which members of the public can raise a complaint about a charity. We are not aware of the reasons for this change but are not convinced that trustees having to use a complaints process to share important information with OSCR is appropriate. We would like to see reporting of this nature by charity trustees fall within the scope of the review. One option could be to place the reporting of certain matters by trustees to OSCR on a statutory footing, for example, through amending Section 66 of the 2005 Act on Charity trustee duties.

We are also supportive of the technical areas referred to in question 9 being included in the review and we refer to other matters of a technical nature we believe should be included within the scope of the review in our response to question 10.

Question 6

What topics should it not cover, and why?

Response

Other than matters which have already been addressed within the 2023 Act, we have not identified any specific topics which should be excluded. However, if the review of regulation is several years in the future there will be a point where it would make sense to include the effectiveness of changes brought about by the 2023 Act within the scope of the review.

Question 7

In the past consultations some people have suggested aspects of charity regulation they think should be reviewed. These are listed below.

Charitable purposes

There are 16 charitable purposes set out in [section 7\(2\) of the 2005 Act](#). Each charity must have at least one of these purposes in their written constitution. The purpose(s) make clear what the charity has been set up to achieve, its broad aims.

Public benefit

Public benefit is the way a charity makes a positive difference to the public (either in general or to a specific section) through the activities it carries out when advancing its charitable purposes. This is set out in [Section 8 of the 2005 Act](#).

Charity trustee duties

All charity trustees have legal duties and responsibilities under charity law. A duty is something that you must do, and all the duties must be met. The duties are set out in [Section 66 of the 2005 Act](#). More information on these aspects of charity regulation and other requirements can be found in OSCR's guidance: [OSCR | Guidance and forms](#).

Top of Form

Question 7A

Charitable purposes: Should this aspect of charity regulation be reviewed?

- Yes
- No
- Don't know

Question 7B

Public benefit: Should this aspect of charity regulation be reviewed?

- Yes
- No
- Don't know

Question 7C

Charity trustee duties: Should this aspect of charity regulation be reviewed?

- Yes
- No
- Don't know

Question 8

Is there anything else you think should be included in a review of charity regulation? Please explain what and why.

Response

We cover the matters we think should fall within the scope of the review in our responses to questions 2, 5, 7, 9 and 10.

Technical areas

There are three technical topics that have been identified to form part of a 'technical workstream', separate from any wider review of charity regulation. Details of these topics can be found in the Annex.

Reorganisation of statutory and Royal charter charities**Question 9A**

Should this technical topic be reviewed?

- Yes
- No
- Don't know

Incorporation to a Scottish Charitable Incorporated Organisation (SCIO)**Question 9B**

Should this technical topic be reviewed?

- Yes
- No
- Don't know

Audit income thresholds**Question 9 C**

Should this technical topic be reviewed?

- Yes
- No
- Don't know

10. Are there any other technical issues you think should be added to the technical workstream?

Response

We believe that there are additional matters of a technical nature which should be covered within the scope of the review to address some practical challenges which can impact on charities and their advisers. These are highlighted below, along with the recommendation that the external scrutiny regime is reformed to ensure that it is both proportionate and effective.

Chapter 6 of the 2005 Act on Charity accounts

There are inconsistencies relating to the scope of the 'statement of account' between the accounting regulations and Chapter 6 of the 2005 Act on Charity accounts and within the accounting regulations themselves. These inconsistencies need to be resolved to ensure that both the trustees' and the auditor's responsibilities towards a charity's 'financial statements' and 'trustees' annual report' are clear and expressed correctly from a technical standpoint.

These inconsistencies mean that the law is unclear as to whether the 'statement of account' means the 'financial statements' only or the 'financial statements' plus the 'trustees' annual report'. Within Scottish charity law the use of the term 'statement of account' appears to apply solely to the 'financial statements' on some occasions but on other occasions it appears to apply to both the 'financial statements' and the 'trustees' annual report' combined.

The main technical challenge arising from this is that a charity's trustees are responsible for ensuring financial statements prepared under the Charities Statement of Recommended Practice (SORP) give a true and fair view, but the trustees' annual report is not designed to give a true and fair view. For auditors this is also problematic in a very practical sense as they provide reasonable assurance that the financial statements give a true and fair view, but they do not provide reasonable assurance on the trustees' annual report.

This means that auditors are currently relying on a letter of comfort issued by the Scottish Government to the Auditing Practices Board (a former board of the Financial Reporting Council) in issuing any auditor's report for a Scottish charity. FRC guidance (Practice Note 11 on the Audit of charities in the United Kingdom) currently states that:

"Scottish charity law requires the auditor to consider the Trustees' Annual Report and to state whether or not the report meets the requirements of the regulations and an opinion, where the auditor has formed one, that there is a material inconsistency between the annual report and the rest of the statement of account. Although there is some legal uncertainty, the Scottish Government has given a provisional view that the Annual Report is outside the scope of the 'true and fair' view and have said that they will clarify the legislation on this point when a suitable legislative vehicle is available."

Scottish charity accounting regulations 2006: external scrutiny requirements

Building on our response to question 5, we set out further detail about the need to include a review of the external scrutiny requirements placed on charities, beyond consideration of the income criterion which forms part of the audit threshold.

We believe it is appropriate to consider asking, "Is an audit the appropriate form of scrutiny for all charities which currently require one?" This should be considered in the context of longer and more complex auditing standards and the level of sophistication of charities now falling within the audit regime compared to 2006 when the accounting regulations were first implemented.

The absence of a year's grace when the audit threshold's size criteria are breached, for example, due to the receipt of legacy income or a multi-year grant around the end of the financial year, means a charity may need to find an auditor at late notice for one year only. This can lead to a charity failing to meet its filing deadline due to the practicalities of securing an auditor at short notice. Late accounts are a particular challenge for charitable companies as filing late with Companies House can lead to fines, and, in some cases, the threat of criminal sanctions against the trustees, who are its directors under company law. We believe it is desirable for the audit threshold to be revised to provide a year's grace to avoid 'one off' audits, as is the position under the Companies Act 2006.

We would also like to see consideration being given to the introduction of an independent examination threshold to remove the smallest charities from independent examination. This should include an assessment of the value of the smallest charities receiving an independent examination.

We believe that if the audit threshold is to be increased, that OSCR should be required to issue directions to independent examiners setting out the scope of the work that they need to undertake. This is the approach required of the Charity Commission for England and Wales. Having directions would help independent examiners to understand better their responsibilities leading to an improvement in the quality of independent examinations. It is possible that primary legislation, rather than secondary legislation, may be needed to require OSCR to issue directions to independent examiners.

Charities Accounts (Scotland) Regulations 2006: additional matters

There are several additional technical matters which we believe need to be resolved specifically removing references to a specific edition of the Charities SORP and to other specialist SORPs so that the regulations don't need to be amended for new editions, alignment of trustees' responsibilities towards the trustees' annual report with the responsibilities of directors towards the directors' report under the Companies Act 2006, and the preparation of consolidated accounting regulations picking up all extant changes since the regulations were first prepared.

Section 67 of the 2005 Act on the Remuneration for services

Reform is needed so that insolvency practitioners can be paid without the need to use a legal work around of the prohibition on charities being unable to remunerate 50 per cent or more of the charity's trustees.

Section 16 of the 2005 Act on Changes requiring OSCR consent

There is tension between the duty of company directors to protect the interests of creditors where a charitable company faces severe financial distress or insolvency and the need to give OSCR 42 days' notice before placing a charitable company into an insolvency process, most often winding up.

Regulations made under section 64 of the 2005 Act on Regulations relating to Scottish Charitable Incorporated Organisations (SCIOs)

The Accountant in Bankruptcy (AiB) is required to administer SCIO sequestrations. Insolvency practitioners who are accustomed to dealing with sequestrations are not currently permitted to act as trustees in SCIO sequestrations. In order to create more capacity to deal with any increase in SCIO sequestrations as may occur, it would be helpful if Scottish charity law could be amended to enable insolvency practitioners to act as trustees in SCIO sequestrations in addition to the AiB.



CA House, 21 Haymarket Yards, Edinburgh, UK, EH12 5BH
+44 (0) 131 347 0100
connect@icas.com
icas.com

 @ICASaccounting

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