

Call for evidence on The Charities (Regulation and Administration) Bill

Response from ICAS to the Social Justice and Social
Security Committee of the Scottish Parliament

3 February 2023



Introduction

The Charities Panel submitted comments to the Scottish Parliament's Social Justice and Social Security Committee on its call for evidence on The Charities (Regulation and Administration) (Scotland) Bill. The Bill was introduced to the Scottish Parliament on 15 November 2022.

Our comments were submitted online. We set out those comments below in the next section: 'Responses to specific questions'.

Responses to specific questions

Question 1

What are your views on the Scottish Government's consultation and engagement process leading to the Bill?

Response

The ICAS Charities Panel responded to both consultations conducted by the Scottish Government on proposed changes to Scottish Charity Law. We submitted our first consultation response in March 2019 and the second in February 2021.

In our response to the first consultation there was scope to provide commentary on areas for reform not covered by the consultation. The second consultation was in the form of an online survey which focused solely on the areas of The Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) highlighted for reform by the Scottish Government in the first consultation.

The ICAS Charities Panel also met with the Scottish Government's Charity Law Team and the Office of the Scottish Charity Regulator (OSCR) in January 2023 to discuss The Charities (Regulation and Administration) (Scotland) Bill (the Bill) and our previous consultation responses.

We broadly welcome the proposals in the Bill and We recognise that the charity law reform process has been drawn out because of the Scottish Government's focus on the pandemic. We were also pleased to have an opportunity to engage with the Charity Law Team and OSCR outside of the formal consultation process. We found the meeting very useful.

However, we believe a post-implementation review of the 2005 Act is long overdue, given how long it is since the formal establishment of a Scottish charity regulator and the implementation of the two-part charity test.

Apart from some limited changes to the 2005 Act through The Public Services Reform (Scotland) Act 2010, the Act remains unchanged. We acknowledge that there have been changes to accompanying regulations since the 2005 Act came into force.

We welcome the Scottish Government's commitment to carry out a wider review which is mentioned in Q3. However, we are disappointed that this is unlikely to happen until after the elections in May 2026.

Question 2

How has the charity sector changed since 2005, and why is an update or strengthening of legislation needed?

Response

We believe it is important for the 2005 Act to be reviewed and updated in light of experience and changing circumstances.

The Bill's proposals have largely been requested by OSCR in light of its experience as a statutory regulator over a period of nearly 17 years. We welcome the strengthening of OSCR's powers and the measures to increase the accountability of trustees as stewards of charitable assets.

We particularly welcome proposals to make charities more transparent by requiring OSCR to publish the trustees' annual reports and accounts of Scottish charities.

OSCR currently publishes these to some extent, but there is no statutory requirement to publish. The names of charity trustees and other information have to be redacted, even though members of the public have the right to request unredacted reports and accounts directly from charities.

Routine redactions won't be necessary once OSCR has to publish reports and accounts, except to the extent of exemptions awarded for safety and security purposes, allowing OSCR resources to be redeployed elsewhere.

There are three charity law jurisdictions in the UK: Scotland; England and Wales; and Northern Ireland, each with a separate charity regulator. There is therefore scope for charity regulators within the UK to learn from the experience of their colleagues. We welcome the provisions which seek a degree of alignment with charity law elsewhere in the UK.

Scotland is currently unique in requiring charities which operate in Scotland but are primarily based elsewhere in the UK to register with OSCR. These charities are known as cross-border charities. Some consistency in both law and regulation is therefore helpful to cross-border charities as it reduces, albeit does not eliminate, the complexities attached to being registered in more than one jurisdiction.

There are cross-border provisions within the Charities Act (Northern Ireland) 2008: these differ from the requirements of the 2005 Act and have yet to be implemented.

Under the Bill, OSCR will acquire the power to give positive direction to charities, i.e. they will be able to direct a charity's trustees to undertake a specific action or actions. It will be vitally important to maintaining the independence of the sector, that this power is exercised alongside OSCR's powers of inquiry and investigation and in accordance with the regulatory principles in the 2005 Act.

Section 9 of the 2005 Act states that:

"In performing its functions OSCR must, so far as relevant, have regard to—

- (a) the principles under which regulatory activities should be proportionate, accountable, consistent, transparent and targeted only at cases in which action is needed, and
- (b) any other principle appearing to OSCR to represent best regulatory practice."

Question 3

The Government is committed to carrying out a wider review of charity law after the passage of this legislation. What are your views on a review?

Response

As we say under Q1 we support the commitment to carry out a wider review of Scottish charity law. We recommended in our 2019 consultation response that a full, post-implementation review should be carried out. We highlighted several matters, where we feel, based on our experience, reform is needed.

We think the review should be carried out during this parliamentary term. However, we still welcome the commitment.

In our response to Q10 we highlight areas where we think further reform should be considered.

Question 4

What are your views on the Bill's Financial Memorandum and the various impact assessments published by the Scottish Government?

Response

We have no comments on the Bill's Financial Memorandum and various impact assessments prepared by the Scottish Government.

However, it is vital that OSCR is properly resourced to exercise its new powers and responsibilities.

Question 5

Will the Bill lead to the Scottish public being better protected, and will charity regulation become more transparent?

Response

In Q2, we supported proposals for OSCR to have to publish the trustees' annual reports and accounts of each Scottish charity. This will increase the transparency of individual charities and, ultimately, the sector as a whole.

The publication of reports and accounts will make it easier for charities' stakeholders and the public to access historic information about a charity, its activities, its financial performance and its financial position.

We welcome the establishment a register of trustees and this will strengthen OSCR's ability to maintain contact with all charities on the register and, ultimately, protect charitable assets. The establishment of the register of trustees will be an additional regulatory duty for both OSCR and the sector, although Scottish Charitable Incorporated Organisations (SCIOs) already have to maintain a register of trustees, and charitable companies have to maintain a register of directors, who are also the charity's trustees. Information on a company's directors is already publicly available through the register of companies maintained by Companies House.

We welcome strengthening OSCR's powers as long as these are used proportionately.

Question 6

What are your views on the extent to which the Bill matches OSCR's original proposals, as set out in 2018?

Response

The Bill broadly matches OSCR's ten original proposals. However, we note there are some differences.

We welcome the new proposal to establish a register of mergers which will help make sure that charities receive legacies even if the charity in existence at the time a will was written has merged with another charity or charities, and/or, has changed its legal form. This will mean that trustees no longer need to maintain a 'shell' charity to receive legacies. This will reduce the administrative burden on charities currently affected or which may be affected in future.

We understand that plans to include provisions relating to the reorganisation of statutory charities and charities incorporated under Royal Charter can't be taken forward in this Bill. We hope to see developments in this area as part of the intended wider review.

We also note that some additional minor amendments, and amendments designed to ensure Scottish charity law remains close to the law in other UK charity law jurisdictions have been made.

Question 7

Do you think the Bill makes it easier or more difficult to start and run a charity?

Response

We don't believe the Bill will make it more difficult to start a charity. There are no changes to the charity test proposed and a new charity should be able to communicate information about its trustees to OSCR for inclusion on the register.

As we say under Q6, the introduction of a mergers register will reduce the administrative burden on charities, which would otherwise need to maintain a 'shell' charity for the receipt of legacies.

We recognise that introducing a register of trustees as part of the Scottish Charities Register will mean more effort for charities, including the on-going maintenance of information. However, we think that on balance this is the right thing to do.

As we outline under Q5, SCIOs and charitable companies already have to maintain a register of trustees (in the case of a charitable company, these are the directors for company law purposes). Keeping an internal register is also good governance, so communicating information about trustees to OSCR is an extension of that good governance.

However, introducing a register of trustees, will be a big change for charities. It's important that changes are clearly communicated well in advance of implementation to trustees, especially to the trustees of charities with no or limited administrative support.

The Bill introduces safeguards for charities where making information public could put the safety and security of its trustees, staff, service users or premises at risk. Charities will need to make a case to OSCR to receive exemptions from public disclosure. It's vital that the process for applying and approving disclosure exemptions is straightforward and that charities have enough time to have exemptions approved in advance of having to comply with registration requirements, including the registration of trustee information.

For charities with a high number of trustees, thought should be given to limiting the number of trustees any charity needs to share with OSCR. This will mostly likely be an issue for Designated Religious Charities (DRCs). Currently, the Charities Accounts (Scotland) Regulations 2006, allow for charities preparing receipts and payments accounts to limit the number of trustees named in their trustees' annual report to 50. Another option, if this issue is found to impact on DRCs only, would be to consider providing this group of charities with a specific exemption.

While it is self-evident that any charity receiving a positive direction may view this as a burden, we think it will be an important tool for OSCR in exercising its powers. However, it's important that this new power is exercised in accordance with the regulatory principles set out in the 2005 Act.

Question 8

Will additional administrative burden be placed on charities? Would this be disproportionate for smaller charities?

Response

We have commented on this matter under Q5 and Q7.

The trustees of smaller charities could feel daunted about the implementation of a register of trustees both in terms of making sure they comply with the requirements and from the perspective of securing disclosure exemptions from the public register on the grounds of safety and security.

By informing the sector well in advance about the need to register trustees making sure that charities are supported through the implementation process, OSCR should be able to address some of the concerns.

Question 9

Does the Bill bring the Scottish regulatory system into line with other parts of the UK? Why is this important?

Response

We haven't reviewed the Bill in detail to check the extent to which it brings the Scottish regulatory system into line with other parts of the UK. However, we support the approach taken in the Bill to try to align the Scottish regulatory system for charities with those in the rest of the UK.

Question 10

Do you have any other comments or concerns about specific sections of the Bill, or about the Bill more generally?

Response

There are other aspects of the 2005 Act and accompanying regulations we believe require review and amendment.

Some of the issues we raise below could be addressed as the Bill progresses through parliament. However, we understand that other matters will need consultation and therefore it won't be possible for these to be considered further until the planned wider review takes place in the next parliamentary term.

The matters highlighted below from our comments on 'Section 35: asset transfer schemes' to 'Regulations made under section 64 about the winding up, insolvency or dissolution of a Scottish Charitable Incorporated Organisation (SCIO)' have been lifted from our March 2019 consultation response. Where additional wording has been added by way of clarification to our March 2019 consultation response square brackets have been used.

Since we submitted these comments another important issue has emerged which we believe requires consideration by the Scottish Government and that is the audit threshold in the Charities Accounts (Scotland) Regulations 2006 (the 2006 Regulations).

We have become aware over a period that charities are finding it increasingly difficult to appoint an auditor. At the moment the evidence is anecdotal. However, we believe that over time there is a risk that charities needing an audit may not be able to appoint an auditor, meaning that they would be unable to file annual accounts with OSCR, which comply with the 2006 Regulations and the 2005 Act.

There has been a decline in the number of UK registered audit firms over many years coinciding to a large extent with increases in the audit threshold for companies: the current audit threshold for a standalone private company has been in place since 2016. Further information on audit thresholds and the fall in UK audit registered firms is set out below.

The gap between the audit threshold for Scottish charities in the 2006 Regulations and the Companies Act 2006 audit threshold is now considerable. This combined with economic conditions and increased regulatory requirements means that for audit registered firms it is increasingly difficult to offer audit services to charities for a fee that makes charity audits financially viable for firms and affordable to charities.

A Scottish charity is required to have an audit if in any financial year:

- It has gross income of £500,000 or more, or
- The aggregate value of its assets (before deduction of liabilities) at the end of the financial year exceeds £3,260,000, or
- It is required to do so by the constitution of the charity, any other enactment, or on the instruction of its trustees.

This threshold has been in place since 1 April 2006.

In Scotland, any charity which does not receive an audit is required to have an independent examination, which is a lighter touch form of external scrutiny.

The audit threshold for charities in England and Wales is constructed in a similar way although there are some differences. The key difference is that the income condition in England and Wales is gross annual income greater than £1 million.

In contrast (other than in its first year) a company requires an audit under the Companies Act 2006 if it exceeds two or more of the following in consecutive financial years:

- An annual turnover of more than £10,200,000.
- Assets of more than £5,100,000.
- More than 50 employees.

Between 31 December 2001 and 31 December 2021, UK wide audit registered firms fell from 11,172 to 4,745: a fall of 57.5%. The latest information we have from the Joint Audit Register is that the number of audit registered firms at the end of 2022 is 4,352.

We believe that any proposal to increase the audit threshold would need public consultation and a wider consideration of the external scrutiny regime for Scottish charities. For example, in the commentary below we recommend giving OSCR the power to issue Directions setting out the work an independent examiner must undertake. This would strengthen the independent examination regime and we believe that an increase in the audit threshold would need to be accompanied by measures to strengthen independent examination.

Section 35: asset transfer schemes

The Scottish Ministers have exercised their powers under the 2005 Act to issue regulations in all areas, except for the power to issue regulations under section 35(1). A consultation was conducted during 2011 and 2012 on proposed regulations. ICAS was heavily critical of the proposals which we believe could have placed the stakeholders of Scottish charities and other organisations within the scope of the regulations at risk, including beneficiaries and creditors.

Given the challenges of issuing regulations under section 35(1), we recommend that section 35 is reviewed and, if necessary, amended or withdrawn. If there is no realistic prospect of regulations being issued then it may make sense to withdraw the provisions on asset transfer schemes.

Section 44: Accounts

There are several matters in relation to Section 44 and the Scottish charity accounting regulations 2006 which need to be updated, including the following four key matters:

1. The inclusion of the trustees' annual report within the "statement of account"

Section 44 and the accounting regulations require amendment to make it clear that the trustees' annual report is not part of the statement of account.

We believe amendments to Section 44(1)(b), Regulation 8 and Regulation 9 are required to remove the trustees' annual report from the scope of the "statement of account" for the following reasons:

- The trustees' annual report is not designed to sit within the accounting framework for accounts prepared in accordance with the Charities SORP (FRS 102) which give a true and fair view or prepared on a receipts and payments basis to properly present the affairs of a charity.
- There is an inconsistency within the accounting regulations. In two places within the regulations the "statement of account" is defined as including the trustees' annual report (Regulations 8 and 9) and in two places the "statement of account" is defined as not including the trustees' annual report (Regulations 10 and 11). It is not possible for both scenarios to be correct therefore the current wording undermines the accounting regulations.
- Section 44 does not refer to the trustees' annual report, the implication being that it is included within the statement of account.

- We believe that the policy intention is that a consistency check between the trustees' annual report and the accounts is all that is required [by the auditor or independent examiner]. Suitable amendments to the law are required to make this policy intention clear.

[Under the Companies Act 2006, company directors' responsibility for the content of the Directors' Report is stronger relative to charity trustees' responsibility for the content of the Trustees' Annual Report. The company law requirements must be met by the trustees of charitable companies. These differences flow through to the wording of charitable companies' auditor's reports. Therefore, it would be worthwhile giving consideration to aligning Scottish charity law with the related aspects of company law providing a level playing field of responsibility across the Scottish charity sector.

Section 496 (1) of the Companies Act 2006 on the 'Auditor's report on strategic report and on directors' report states':

In his report on the company's annual accounts, the auditor must-

- (a) state whether, in his opinion, based on the work undertaken in the course of the audit—
 - (i) the information given in the strategic report (if any) and the directors' report for the financial year for which the accounts are prepared is consistent with those accounts, and
 - (ii) any such strategic report and the directors' report have been prepared in accordance with applicable legal requirements,
- (b) state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, he has identified material misstatements in the strategic report (if any) and the directors' report, and
- (c) if applicable, give an indication of the nature of each of the misstatements referred to in paragraph (b).]

2. The references to specific editions of Statements of Recommended Practice (SORPs) for charities and specialist charities (i.e. housing and education bodies)

The reference to specific editions of SORPs in the Scottish charity accounting regulations means that every time a SORP is updated to incorporate changes to financial reporting standards issued by the UK Financial Reporting Council, amendment regulations are being issued. In reality financial reporting standards take precedence over specialist SORPs and charitable companies are required under UK company law to apply extant UK financial reporting standards. Therefore, it is unhelpful for the Charities Accounts (Scotland) Regulations 2006 to take an inconsistent approach. There is no benefit to be derived from having charities bound to a specific edition of a SORP if amendments have been made to the underlying standards. There are robust arrangements for setting and issuing SORPs and it would be more efficient if references to SORPs within the Regulations were edition neutral.

3. Consolidation of the Scottish charity accounting regulations

There have been several amendment regulations issued in relation to the Scottish charity accounting regulations and it would be timely to issue consolidated regulations. Amendments include changes to thresholds for accounts preparation and external scrutiny and it would be much clearer for charities and their advisers if all the changes made to the regulations since they were published in 2006 were included in one set of updated regulations.

4. Directions for independent examiners

OSCR has no power to issue Directions to independent examiners, i.e. steps an independent examiner must undertake in order to be able to prepare their independent examiner's report.

The Charity Commission for England and Wales (CCEW) has such a power under section 145(5)(b) of the Charities Act 2011. The Charity Commission for Northern Ireland has a similar power.

Directions would provide clarity about the scope of the work an independent examiner needs to undertake before being able to issue an independent examiner's report in accordance with the Charities Accounts (Scotland) Regulations 2006.

OSCR publishes helpful guidance for independent examiners but it is good practice rather than mandatory guidance. We believe that formal Directions have the potential to improve the quality of the work undertaken by charity independent examiners. However, such a power should be limited to the issuing of Directions which do not extend the work of the independent examiner beyond the scope of the 2006 Scottish charity account regulations.

An OSCR power to issue Directions may be possible through an amendment to the Charities Accounts (Scotland) Regulations 2006, as a case could be made that this would fall within the existing power in section 44(4)(g) of the 2005 Act which allows the Scottish Ministers to make regulations about "the examination or audit of the statement of account". However, as this would be an explicit new power for OSCR, there could equally be a case for adding a power to issue Directions to independent examiners within section 44 of the 2005 Act.

Section 67 on remuneration for services and the remuneration of insolvency practitioners

Under the 2005 Act, Scottish charities are unable to remunerate 50 per cent or more of the charity's trustees. The appointment of an insolvency practitioner to a charity is also an appointment as a trustee. Under charity law, the insolvency practitioner cannot be remunerated.

Insolvency procedures have associated costs and in order for the insolvency practitioner to be paid for their services, these costs need to be included within the associated costs the Court approves. While there is a legal route to addressing the charity law prohibition on remuneration, it would be preferable for the law to be amended to enable insolvency practitioners to be paid for their services.

Section 16 changes requiring OSCR consent and the duties of company directors: charitable companies facing severe financial distress or insolvency

There is an inherent conflict between the duties of company directors and the duties of trustees when a charity which operates through a company is facing severe financial distress or insolvency.

Directors have a duty, under the Companies Act 2006 and Insolvency Act 1986, to take steps to protect the interests of creditors. In many circumstances this will involve taking a decision to place the company into an insolvency process, most often winding up. Section 16(2)(c) and 16(4) of the 2005 Act requires the charity to give OSCR 42 days' notice prior to taking steps to wind itself up. There is often an urgent need for the appointment of an insolvency practitioner and the 42 days' notice period is impractical in such circumstances.

The charity's trustees, who are the directors under company law, are faced with competing legislative requirements. In order to minimise the conflict in practice there is often significant co-ordination required between the proposed insolvency practitioner and OSCR to allow notification to be made and a letter of consent to be delivered by OSCR which can be exhibited with the winding up petition to the Court. The process is burdensome and adds unnecessary cost to the legal process of winding up.

Regulations made under section 64 about the winding up, insolvency or dissolution of a Scottish Charitable Incorporated Organisation (SCIO)

The Accountant in Bankruptcy (AiB) is required to administer SCIO sequestrations, although we are aware that very few have occurred since charities were able to operate through a SCIO.

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 in the future, it would be helpful if Scottish charity law was amended to enable insolvency practitioners to act as trustees in SCIO sequestrations in addition to the AiB.


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