

3. Types of external scrutiny

3.1 What is independent examination? **For all interest groups**

Independent examination is one of the two forms of external scrutiny that may be carried out under the statutory provisions in Scotland. Broadly speaking, an independent examination involves reviewing the accounting records and the annual accounts of the charity and considering whether the annual accounts are a fair reflection of the underlying records. When carried out properly, an independent examination provides a degree of comfort that the figures in the accounts, including the Trustees' Annual Report, present an accurate picture of the financial activity of the charity during the accounting period.

Also involved in the process is consideration of any unusual items in the accounts that may require further discussion or explanation from the charity trustees. The independent examination seeks to ensure that the charity's accounts, including the Trustees' Annual Report, fulfil the requirements of the 2006 Regulations and adequately reflect the operations of the organisation for the period concerned.

3.2 Independent examination versus audit **For all interest groups**

An independent examination is a form of external scrutiny which:

- offers an assurance that nothing has been found that needs to be brought to the attention of readers of the accounts
- is less rigorous than an audit
- is less costly than an audit.

The independent examiner's report is prepared on an 'exception' basis. This means that there is an assumption that the examiner is content with the accounting records and accounts unless they specifically state otherwise. The report is intended to be simpler than an audit and no opinion is expressed on the accounts.

In contrast, an auditor is required to build up a body of evidence and express an opinion on the accounts. The opinion given in an audit depends on the nature of the accounts that have been prepared.

- If receipts and payments accounts have been prepared, the opinion will state whether or not the accounts 'properly present' the receipts and payments for the charity for the financial year. In practice, OSCR expects very few charities preparing receipts and payments accounts to have an audit.
- If fully accrued accounts have been prepared, the opinion will state whether the accounts provide a 'true and fair view' of the financial affairs of the charity.

Historically, the term ‘audit’ has been used loosely to describe any external scrutiny of accounts, although since 1990 it has had a more specific meaning. Under the 2006 Regulations, if the term ‘audit’ is used in a charity’s constitution or governing document, the charity must have its accounts audited by either:

- a registered auditor
- the Auditor General for Scotland
- an auditor appointed by the Accounts Commission for Scotland (responsible principally for public bodies).

Audits are more commonly required for larger charities, although smaller charities may also require an audit. It is possible that the governing document of the charity may contain specific terms requiring the accounts to be audited or referring to an ‘auditor’. In such a situation, the charity is required to have its accounts audited as stated above. An independent examination would not be acceptable in such cases. In other situations, ‘audit’ may be instructed because that has been the custom in the past.

Milestone 1 –

- **Does the governing document of the charity require an audit to be carried out rather than an independent examination?**

OR

- **Is it simply custom and practice for the charity to have its accounts audited?**

If the answer to either of these questions is yes, the charity trustees may wish to pause and consider their options:

- if the governing document contains a requirement for audit, the charity trustees may wish to consider changing the governing document
- where it has simply been custom and practice for the accounts to be audited, the charity trustees can adopt a different policy and elect instead for an independent examination
- in any event, it may be worthwhile for the charity trustees to contact funders to determine whether an audit is really required or whether independent examination is adequate. The charity trustees may wish to consider whether any trading issues or related parties necessitate an audit being carried out
- if the charity trustees *choose* to have the accounts audited, this may have a cost implication.

3.3 Changing the governing document **For charity trustees**

The governing document of a charity may take many forms including a 'Constitution', 'Memorandum and Articles of Association', 'Trust Deed' etc.

Where the governing document contains either:

- a requirement to prepare fully accrued accounts regardless of the level of income (non-company charities)
- a requirement for audit.

then the charity trustees may wish to consider whether these provisions are still necessary, or whether they might wish to change their governing document.

Charity trustees should note that changes can only be made where the governing document provides the necessary power for the charity trustees to make such a change. If there is no such power within the governing document, the charity trustees would have to use the charity reorganisation provisions within the 2005 Act. For further information on the reorganisation provisions and notification of changes to the governing document, please refer to OSCR's Charity Reorganisation Guidance and Consents and Notifications Guidance, as applicable. These may be downloaded from the OSCR website at www.oscr.org.uk.