Financial reporting by smaller charities: drivers of the cash/accruals choice

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Financial Reporting by Smaller Charities: Drivers of the Cash/Accruals Choice

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ABSTRACT

All UK charities are required by law to publish annual accounts. This study is concerned with the choice faced by smaller charities whether to use the accruals (charities SORP) or receipts and payments (R&P) basis. A study of financial reporting by 90 smaller Scottish charities, supplemented by interviews, examined drivers behind the choice of approach. Both accruals and R&P accounts were considered legitimate means of reporting and the choice was found to be driven largely by perceived preferences of users of accounts rather than costs.

KEYWORDS

Charity accounting; cash accounting, accruals accounting, Scotland, charity regulation.

IMPACT STATEMENT

This study shows that whilst R&P accounting has only been available to Scottish charities in the £100,000 to £250,000 income band since 2011, it is already being used by almost 4 in 10 charities in that band. Charities consider that both the accruals and R&P bases are legitimate means of reporting to stakeholders and the perceived requirements of the stakeholder influence the accounting choice to a greater extent than cost-constraints. The implication for policy makers is that both approaches have their merits in a framework of charity regulation with neither being considered more legitimate than the other.

1. Introduction

1.1 Background and context

All UK charities have duties in law[1] to publish annual accounts which form a vital avenue of communication with stakeholders; a charity's continued success depends upon public trust and confidence (Charity Commission, 2004)[2]. Devolved charity law in the UK requires slightly differing frameworks for accounting and reporting in each jurisdiction (England & Wales, Scotland, Northern Ireland), all requiring larger charities to prepare accounts on a true and fair basis complying with the Charities SORP (Statement of Recommended Practice on Accounting and Reporting by Charities).[3] However, over 80% of all charities are small (NCVO, 2016) and to alleviate the complexities of charity accounting for the smaller charity (with gross income not exceeding £250,000), a simpler alternative cash-based accounting, known as the receipts and payments (R&P) basis is permitted in each jurisdiction subject to certain conditions. If legislation offers this choice of a simpler approach, why is it not universally adopted by all eligible organisations?

1.2. Research Aims and Design

This paper is concerned with this choice faced by smaller charities. The focus is on Scottish charities registered with the Office of the Scottish Charity Regulator (OSCR), where the R&P regime is more prescriptive than in England & Wales or Northern Ireland. The OSCR Register (accessed May 2019), showed 24,593 registered charities, 19,638 (80%) with income under £250,000.

The study had three aims. The first was to assess the extent of the practice of R&P accounting amongst eligible charities. This quantitative phase focused on charities with income levels between £100,000 and £250,000 based in the Lothians and Borders region of Scotland.

The second aim was to explore the influences that drive the decision to adopt either R&P or accruals accounting, based on factors evident from the accounts themselves supplemented by interviews with key individuals in a limited number of charities.

The final aim was to investigate the findings in line with existing literature to provide some rationale for the choice adopted based on underlying factors.

The study was crafted using a mixed method approach, to provide credibility, validity and confidence of the results (Bryman & Bell, 2011; Cunliffe, 2010; Easterby-Smith et al., 2012; Gill & Johnson, 2010), seeking "to use the results from one method to help develop or inform the other method, where development is broadly construed to include sampling and implementation" (Greene et al., 1989, p259). In this case: an initial quantitative study assessed the extent of R&P accounting in one region of Scotland and sought information from these public documents that might point to drivers of the reporting decision. This created a sample for the subsequent qualitative work intended to gain deeper insight into the reasons for a charity adopting a particular accounting/reporting regime.

1.3. Legislation in Scotland and the accounting choice facing the small charity

Charities in Scotland are subject to the Charities and Trustee Investment (Scotland) Act 2005. Chapter 6 of the 2005 Act refers to a charity's duties to keep proper accounting records[4] and from them prepare a statement of account and report on the activities for each financial year. The Charities Accounts (Scotland) Regulations 2006 and subsequent amendments detail the format which charity accounts[5] must take and the applicable income thresholds regarding form of accounts and levels of external scrutiny necessary (Table 1).

[insert table 1]

Regulation 8 prescribes the form accruals accounts should take, in line with the Charities SORP (Charity Commission & OSCR, 2014), applying UK accounting and reporting regulations, now in the form of FRS102[6]. Under the regulations, all Scottish charities must adopt the accruals basis and follow the Charities SORP (except for a few specialized charities where other SORPs apply), unless specifically permitted to produce receipts and payments accounts.

Regulation 9 stipulates that where gross income is less than £250,000 (£100,000 prior to an amendment that took effect in 2011), and unless required by its governing document, enactment or decision by the trustees, a charity is not required to produce accruals accounts and may opt to prepare its accounts on the R&P basis.

Charitable companies fall outside the scope of this paper as their legal form and incorporation with Companies House necessitate accruals accounting in all cases, but only 25% of Scottish charities up to £250,000 income are companies (OSCR register search, May 2019). The R&P option is available to unincorporated charities and to SCIOs[7] up to £250,000 income, which together account for 59% of the entire Scottish Charity Register.

The R&P basis is a cash-based approach; transactions accounted for at the time of cash receipt/payment, not designed to show a true and fair view, yet explaining all a charity's transactions (Pendlebury & Groves, 2003; Pianca & Dawes, 2009). The Charities SORP states that its recommendations do not apply to charities preparing R&P accounts, and in absence of this direction, looks to the regulatory requirements regarding content and form. In Scotland, Regulation 9 of the 2006 Regulations prescribes the following components of a set of Receipts and Payments accounts:

(a) a receipts and payment account for the financial year;
(b) a statement of balances as at the last day of the financial year
(c) notes to the accounts; and
(d) an annual report for the financial year.

Schedules 2 and 3 of the Regulations detail further what is required under each part – this is much more comprehensive than the requirements in England and Wales[8] where an absence of specific regulations on the content of R&P charity accounts allows freedom to interpret the requirements (Morgan, 2010), although Charity Commission guidance[9] exists.

2. Prior literature

2.1 Accountability and transparency

To achieve charitable status in Scotland, an organisation must meet the two elements of the "charity test" set out in law:[10] exclusively charitable purposes and providing public benefit in meeting those purposes. Scandals and failings in the charity sector tend to be high profile, impacting on confidence sector-wide (e.g. SCVO, 2018) and placing how charities manage their funds under public scrutiny. Transparency and accountability, "providing relevant and reliable information to stakeholders in a way that is free from bias, comparable, understandable and focused on stakeholders' legitimate needs" (Charity Commission, 2004, p1), seek to mitigate the risk of scandal and consequently breed confidence, stimulating increased giving (Connolly & Hyndman, 2013; Hyndman & McMahon, 2010; Katz, 2005).

Stakeholders of a charity usually include donors/funders, beneficiaries, charity members and employees, government and sector bodies and, for a small charity, the local community (e.g. Connolly et al., 2013, Ryan et al. 2014). The Charities SORP was built on conceptual frameworks to meet the financial, non-financial and narrative reporting needs of these stakeholders: it aims to provide a robust reporting and accounting regime enabling charity annual reports and accounts to be a vehicle to discharge accountability to and communicate with the stakeholders (Connolly & Hyndman, 2013; Hyndman & McMahon, 2010; Ryan et al., 2014; Yang et al., 2017). Developed in line with UK accounting and reporting regulations, the current Charities SORP FRS102 (Charity Commission & OSCR 2014) took effect from 1 January 2015.[11]

The evolution of charity accounting and development in the SORP regime has attracted numerous studies in recent years, looking at compliance issues (e.g. Connolly & Hyndman, 2000, 2003; Palmer, 1997; Palmer et al., 2001; Palmer & Vinten, 1998), how improvements in accounting and reporting have been made, particularly regarding technical financial issues (e.g. Hyndman & McMahon, 2010, 2011) and how SORP requirements address accountability and narrative public benefit reporting (e.g. Connolly & Hyndman, 2013; Morgan & Fletcher, 2013) or enhance stakeholder engagement (Connolly et al., 2013), providing a standardized benchmark across the sector. Most research is consequently aimed towards the larger charity, although a few consider the smaller charity and/or cash basis (e.g. Cordery et al., 2019; Cordery & Sim, 2014; Morgan 2008).

2.2 Accounts preparation – practical issues

Cash accounting is considered simpler to apply and easier to understand (e.g. Cordery et al., 2019; Cordery & Sim, 2014; Epton, 2012; Pianca & Dawes, 2009). A study by Morgan (2008), examining the views of independent examiners and funders[12] regarding preparation of accounts on the R&P or accruals basis indicated strong agreement that the regime should be as simple and least time consuming as possible for small charities relying on volunteers. Equally, cash-based reporting should be cost-effective, reducing administration costs, allowing more funds to be applied to charitable objectives (Cordery & Sim, 2014; Crawford et al., 2014).

Morgan (2008) found support for the assumption that R&P accounts are easier to understand, with some agreement that the cash-basis provides a clear factual position, avoiding manipulation from accruals adjustments. R&P accounts align with the cash-flow information that is often used to manage the financial requirements and sustainability of a charity (Cordery & Sim, 2014; Jones & Pendlebury, 1996). However, for those charities with assets (e.g. property, investments), or liabilities (e.g. payroll), is the cash-basis sufficient? Although, it is questionable whether the smaller charity would hold significant assets or liabilities, most respondents in the Morgan study (2008) considered the cash-basis did not reflect a proper view of the charity's financial position, and that crucial details could be omitted from R&P accounts. Non-exchange revenue, such as donated services are only considered under accruals accounts (Crawford et al., 2014), yet can be significant for a small charity. Disclosures in the notes and statement of balances (which are specifically required in Scotland) can help overcome these shortcomings in the R&P format.

2.3 Requirements of the stakeholder in terms of the accounting choice

In terms of stakeholder needs, research by Crawford et al. (2018) noted that priority is often toward regulators and funders. Theoretical frameworks, such as resource dependency theory (Pfeffer & Salancik, 1978), where behaviour of the charity is affected by external stakeholders' resources, may be considered to underpin the rationale for the accounting choice. Irvine (2011) found that stakeholders who may be unfamiliar with business terminology, prefer cash-based information. Morgan (2008) found a slight preferance for accruals accounts by funders, and Cordery and Sim (2014), in a study of small charities in New Zealand, found that resource dependency was a factor in small charities voluntarily adopting accruals accounting.

Perhaps more significant is meeting the information needs of stakeholders (Yang et al., 2017). If these communication requirements are not met, "stakeholders may perceive the organisation as less legitimate…and less worthy of support" (Hyndman & McConville, 2018, p145). Connolly and Hyndman (2013) consider that audited financial statements serve to provide legitimacy in the charitable sector and Breen et al. (2018) consider legitimacy in respect to harmonised accounting standards. Although this may tend to certain stakeholders perceiving accruals accounts as more legitimate, Cordery et al. (2019) confirm that preparers recognise that cash-based accounts are more understandable for some users. Legitimacy theory may therefore be considered to drive the accounting choices of a charity where demands of stakeholders are met by reporting in a way that is useful and relevant to them (Kaplan & Ruland, 1991).

2.4 Audit or independent examination in the UK - the influence of independent examiners

External scrutiny is an essential part of accountability (Connolly & Hyndman, 2013; Jones & Pendlebury, 2004) with accounts of all charities registered in Scotland being subject to examination (Table 1) based on the income level and accounts format of the charity. The independent examination regime was introduced to allow scrutiny of smaller charities' accounts without the expense of a full audit by a range of people from the 'lay' independent examiner (IE) who has relevant charity financial experience, to a professionally qualified IE (Jones, 2002; Morgan 2011; Woodfield, 1987). The research by Cordery and Sim (2014) found links between qualified accountants and accruals accounts, and conversely that charities which did not use a qualified accountant for assurance were more likely to report on the cash-basis. Estimates indicate that an IE performs on average four or five examinations a year, suggesting around 20,000 individuals in the UK act as IEs (Morgan, 2011). Small charities may take the IE's advice on accounts preparation, particularly where in-house accounting experience is lacking.

3. Part 1: The Accounts Review

3.1 Research Scope

This first phase of research was designed to provide a rich source of information from actual accounts of Scottish charities. This phase examined the OSCR record and latest available set of accounts filed with OSCR for all charities with the following characteristics:

(i) annual income of £100,000 to £250,000 (based on latest filed accounts)
(ii) non-company charities
(iii) located in the East Lothian, Midlothian, West Lothian and Scottish Borders local authority areas of Scotland

The income range of £100,000 to £250,000 was selected as charities in this income bracket have only been eligible to choose R&P accounts since 2011[13]. Therefore, some charities in this band may have previously been required to complete accruals accounts, and at this size are more likely than a smaller charity, to operate in a variety of fields, perhaps employ staff and be funded in diverse ways. Charitable companies were omitted as their compliance with Companies Act legislation necessitates accruals accounting. The locations selected were based on accessibility, convenience sampling (Bryman & Bell, 2011). Although this may indicate geographical and cultural limitations, the region selected encompasses rural and urban areas, with differing social needs so was likely to include a wider variety of charities.

3.2 Data Source

A version of the OSCR Register was downloaded on 17th November 2016 and used to identify all charities meeting the above criteria, a total of 97 (Table 2). Although representing only 0.4% of the charities registered with OSCR, they form the entire population meeting the selected characteristics above, encompassing a variety of charity types registered with OSCR.

The OSCR website allows access to the publicly available online records for each registered charity in Scotland, often including a copy of the accounts[14]. Some charities post accounts on their own websites and s.23 of the Charities and Trustee Investment (Scotland) Act 2005, entitles anyone making a reasonable request of the charity to be provided with a set of accounts. To access the latest set of accounts of the charities selected, copies were downloaded from the OSCR website in November 2016, where available, or alternatively from the charity's own website. Written requests (and follow-up emails as appropriate) were sent to the charity's principal contact of 23 charities whose accounts were not available online, with a final review of the OSCR Register made in March 2017.

[insert Table 2]

3.3 Overall finding – the extent of R&P accounting

In total, accounts were obtained for 90 of the 97 selected charities, representing 93% of the sample population. The accounts of the remaining 7 charities were not publicly available on either OSCR's or their own respective website and no response was received from direct requests. The accounts reviewed were the most recently filed for each charity and covered year-ends from March 2015 to August 2016. Each set of accounts was systematically reviewed against a range of criteria, as shown in Table 3, demonstrating a variety of charity types, funding sources and constitutional form.

The results showed that of the 90 sets of accounts, 51 were on the accruals basis, 35 were R&P accounts and 4 were determined as a hybrid[15]. Therefore, the R&P basis was clearly adopted quite widely – by 39% of those considered.

[insert table 3]

3.4 Analysis of the findings

Table 3 displays an analysis of the findings designed to highlight any common factors in the adoption of R&P or accruals accounts and hence identify potential drivers of the reporting decision, as discussed below. Findings are presented purely as descriptive statistics regarding *potential* drivers, to inform the qualitative discussion that follows. Statistical probing of the data generally found only weak correlations, largely on criteria to be expected, such as a slight tendency for charities with larger income to prefer accruals accounts.

3.4.1 Constitutional form and changes in legislation

The R&P basis was adopted across charities of all constitutional forms,[16] proportionally higher amongst unincorporated associations and SCIOs than trusts. In 2011, two significant changes occurred in Scottish charity legislation; the upper threshold for preparing R&P accounts increased from £100,000 to £250,000 and the SCIO[17] form was introduced. Of fifteen charities in the sample that were clearly established post 2011, 60% adopted the R&P approach, considerably higher than for the full sample. This proportion rises to 78% when considering only those formed as SCIOs. Eligibility for R&P accounting is often cited as a benefit of the SCIO form (Morgan, 2018), but of the twelve charities previously formed under other structures and subsequently converting to a SCIO[18], only a third opt for the R&P approach, in line with the total sample.

In 2015, the new Charities SORP was introduced (Charity Commission & OSCR, 2014). Two of those charities reviewed changed reporting format from accruals to R&P from the year 2015-16. Whilst the cause of this change cannot be known from the accounts, the possible drivers of such change will be explored in Part 2.

3.4.2 Charity field and main funding stream

The charities selected in this sample operate in a variety of fields, grouped for analysis as church & faith groups, social care, leisure & community, grant making and heritage, and are reliant on a variety of funding streams, large scale in the form of council core funding, to self-generated funding in the form of trading income, fees and community fundraising. There are similarities between the analysis per funding stream to that of charity field, for example church and religious groups funded by donations and legacies, and social care charities funded by local authority or grant.

The findings show that in both the church & faith groups and leisure & community categories there is an almost even split of accruals and R&P accounts, whereas in the social care category, almost 60% adopted the accruals approach, with a higher proportion in grant making and heritage charities Often charities in these latter categories function more as a traditional business, especially when compared to churches or community groups, for example operating alongside council or social services as a care provider or running heritage properties and often employing staff. They may be funded to deliver services commissioned by the public sector, tendering for grants and meeting funding requirements and perhaps be subject to increased public scrutiny. Regardless of income stream, findings from charities reviewed showed the R&P accounting was more prevalent in those with lower levels of average income (table 3).

3.4.3 External scrutiny considerations

Where the IE/auditor was identified as belonging to an accounting firm or had a professional qualification (based on 58 sets of accounts clearly identifying the IE), approximately 70% were accruals accounts. Seven IE's were responsible for carrying out more than one review, including four with both accruals and R&P accounts. The small numbers do not allow meaningful conclusions to be drawn but do indicate that professional accountants are not necessarily biased towards the accrual's basis being the only approach to charity accounting.

Fee information gathered from the accounts[19] showed that most of the R&P accounts were independently examined for either a waived or nominal fee (77% under £200). In contrast, fewer than 24% of accruals accounts independently examined cost under £200. The most expensive fees, over £1,000 related almost entirely to accruals accounts (excepting one set of R&P accounts).

Where fees were charged (57 charities) an analysis based on the fees per £10,000 of charity income showed the average fees for R&P accounts were £34 per £10,000 and accruals accounts averaged £78 per £10,000 of income. Although a limited sample, this does tend to confirm that R&P accounts may be a more cost-effective approach to accounting and reporting.

4. Part 2: The interviews

4.1 Research Scope

The second phase sought to provide a rich body of opinions to address the second research aim of exploring drivers of the R&P/accruals choice.

A sample of twenty charities of the initial 90 were selected on the following purposive selection criteria (Gill & Johnson, 2010), and approached to take part in an interview:

- to include a mix of fields of operation and constitutional form
- to include a mix of income sources
- to cover both R&P and accruals accounting within the same fields/income sources

- to ensure no connection with the researchers.

A letter was sent to each of the selected charities requesting an interview, and where necessary a follow up email, to the charity's principal contact (held per OSCR Register). Seven charities agreed to an interview in early 2017. A further four responded by email to decline an interview, giving their reasons as insufficient staff time, or having limited experience to be able to discuss their accounting process in an interview. However, three of these charities did provide some useful comments in an email exchange. The participants are referred to as C1 – C7 (from charities which participated in an interview) and C8 – C10 (who provided an emailed response to questions). Refer to table 4 for further details.

[Insert table 4]

Nine of the sample approached did not respond to the interview request. There appeared to be no bias when reviewing characteristics such as charity field or format of accounts, however a subjective comparison of the accounts in the sample showed of those not responding to the request, five had arguably inferior accounts (incomplete, wrong format or filed late), to those agreeing to an interview. Although it cannot be expressly determined, those willing to participate may have more of an interest and understanding of charity accounting and consideration should be given to any no-response bias in the themes emerging in the interviews.

4.2 Participants' experience and background

Of the ten participants, six were treasurers, five with an accountancy background, perhaps suggesting non-accountant treasurers were reluctant to take part. These participants were fully responsible for maintaining accounting records and implementing appropriate financial controls, regardless of whether the charity had other paid staff. Half of these relied on their IE for accounts preparation, with an equal split of accruals and R&P accounts. The remaining four participants were long-standing employees of the charities concerned, finance evolving as part of their role: with one exception, these had no prior accountancy experience. All four used their IEs to prepare their annual accounts, three out of the four being on the accruals basis.

4.3 Analysis of interview findings

Semi-structured interviews were selected as a structured format with open-ended questions to allow the interviewee the opportunity to describe their own perceptions with minimal interference from the researcher, whilst respecting their understanding of the issues discussed (Bryman & Bell, 2011; Easterby-Smith et al., 2012; Gill & Johnson, 2010). The interviews lasted from 40 to 60 minutes, in each case following a guide (table 5), designed to explore the research themes identified above, enabling findings to emerge and to allow further probing of possible drivers identified at the previous stage.

[Insert table 5]

Interviews were recorded, transcribed and analysed based on emerging themes, grouping similar reasons together (Bryman & Bell, 2011) while focussing on language employed and including participants interpretation and reflections (Cunliffe, 2010), hence quotes are analysed and interpreted where they enhance the research findings. A summary of findings is set out below. Although the views represent a small number of charities, from charities in different social areas and from different fields, signs of data saturation were apparent as no new themes were arising.

4.4.1 Awareness surrounding the legislation of accounting choice available

Of the ten individuals, nine were aware that charities with income between £100,000 and £250,000 had the option to prepare R&P accounts; suggesting relevant guidance is reaching charities (perhaps awareness would be lower amongst those declining to take part). Interviewees, C1-C7 were all in post in 2011 when the reporting threshold was increased, and one participant confirmed changing to the R&P regime as a direct result, while a second could not say whether the legislation change influenced their move to R&P accounts. The remainder felt there was no reason to change, either as the accruals accounting wasn't onerous, or they aspired to grow

> *"We were quite close to limit…and we aspire to get more money…we don't want to be skipping back and forwards between [approaches]."* (C4)

Of the seven charities completing accruals accounts prior to the implementation of SORP FRS102 in January 2015 (not all charities would have completed a full year under this standard at the time of the study),[20] one charity changed to R&P accounting as a direct result of the new legislation and another was considering changing with the withdrawal of the simpler FRSSE SORP.[21] Reasons presented were the increased workload involved in meeting the enhanced disclosure under FRS102 (even considering concessions for smaller charities), and issues, actual and perceived, it brings to the smaller charity, such as remuneration disclosures identifying individual's pay.

A further three charities, fully aware of such implications, had not considered changing from accruals accounts, citing good guidance and support from their IE and other bodies. The remaining two charities were unaware of the new legislation (both Social Care charities with reliance on the IE). From this limited group, it is clear that changes in legislation can drive the reporting choice, but only when those responsible for making that choice have awareness of the impact of the legislation and its (perceived) implications.

4.4.2 Accountability and transparency

Despite misgivings about the increased workload, all participants appreciated accountability and transparency as being major concerns and concurred that whichever form, annual accounts are key to discharging accountability on a larger scale to a wider audience. Harmonising with the literature (e.g. Connolly & Hyndman, 2013), the standard of accounts and IE report were viewed as critically important to the perception of good accountability, with some concern expressed at the lack of professional qualification required for scrutiny of the larger charity applying the R&P approach:

> *"Accruals accounts are seen as more professional. … Receipts and Payments accounts are for charities with a lesser volume of money."* (C7)
>
> *"If income is between £100k and 250k [we] wouldn't want the man in the street…I would want a person who knew… [something about charity accounting]" (*C2)

The accounts reviewed subjectively in Part 1, were generally comprehensive in the information they contained; regardless of approach the majority (70%)[22] were prepared to a good standard with narrative and financial information. However, current charity legislation awareness was questionable in some cases, such as incorrect references to legislation, terminology and missing statements or notes. This suggests those scrutinising the accounts and often preparing the accounts and offering guidance are sometimes unaware of current charity requirements.

4.4.3 Influence of the independent examiner (IE)

Seven of the participants noted their IE influenced the accounting approach; those participants without an accounting background were all reliant on the IE:

> *"We prepare accruals accounts because our accountant told us to."* (C4)

"We use an accounting system paid for and recommended [by our IE]. We prepare the accounts as he requests them, he does the rest." (C8)

One participant, on considering changing to the R&P approach because of SORP FRS102, was advised by their IE:

"I do in general recommend fully accrued accounts that comply with the Charity SORP." (C2, quoting an email from their IE)

4.4.4 Preparation considerations

Regardless of approach adopted, half of the participants, all with accountancy backgrounds, acknowledged that R&P accounts are, or are perceived to be simpler to prepare:

"…We changed from being fully accrued to receipts and payments because they changed the guidelines…putting this year's accounts together was a lot easier than in previous years." (C6)

"If very small charity…don't want to be overburdened…far too much detail for simple circumstances, [I] guess that's the situation they [OSCR] are thinking about" (C3)

The remaining participants didn't offer an opinion on the simplicity of the R&P approach as their IE prepared accounts. For them, the format of the accounts was not a consideration, and would not impact the day to day accounting requirements.

4.4.5 Cost considerations

It may have been expected that the R&P regime would be attractive as the lower-cost option. In fact, none of the participants regarded potential cost savings as a driver. All participants agreed the internal costs (staff, administration, compliance) to the charity would be the same, regardless of approach, and some questioned if the fee from an IE would change:

"Our time is the same anyway…" (C4)

"*Not really a cost to the charity as volunteer time and IE doesn't change a fee"* (C6)

Three participants (all chartered accountants), felt that the IE should charge a higher fee regardless of the basis. Being responsible for safeguarding the assets of a charity, it is critical trustees take professional, competent advice when required; it is a "mistake to assume that being a charity is a passport to free advice of adequate quality" (Mullen, 2015, p55).

"Our independent examiner charges £50 plus vat so I rather suspect he doesn't do very much… would rather he charged more to reflect the work he should be doing." (C3)

As the R&P option is provided as a simpler, cost-effective alternative, it was interesting to note that this was not a prime concern for the interviewees, especially when findings in Part 1 showed fees were considerably less for R&P accounts.

4.4.6 Users of accounts

The participants generally thought of 'users' of their annual accounts to be the trustees, wider membership, church umbrella bodies (where appropriate – 41 of the 90 charity accounts reviewed, and 4 of the 10 interviewees were from church charities, a large part of the charity sector in Scotland) and funders. While there was consensus that a simpler approach was beneficial for the trustees/membership, there remained doubt as to whether completing R&P accounts would encourage users to read and become involved more:

"You have to make the accounts…as simple as possible", "numbers have to be there…but the words are far more important." (C1)

"Would they [trustees] actually read a shorter set of accounts…would it really make any difference?" (C3)

For those charities relying on grant funding, there was concern that R&P accounts would not be sufficient:

"When you are applying for funding, they are asking for accounts…don't know if that would just refer to the accruals or that would be alright with receipts and payments." (C5)

4.4.7 Management information

Interviewees expressed the importance of regular management information; cash-based reporting was prevalent, with concern that annual accruals accounts did not reflect this, causing differences and potential confusion among the stakeholders:

"This is the gap for me, how the accounts prepared have nothing to do with the situation on the ground by the time we see them, it's about how you manage the money, especially the money going forward." (C4)

"If I was in a receipts and payments I think I would chase up debtors quicker…I would want [to include them in the right year]." (C2)

4.4.8 Conceptual issues

Conceptual issues were not highlighted by the interviewees as being of great influence on the choice of accounting approach, and no common opinion was offered regarding the approach that best represents the financial position of a charity. The absence of assets and liabilities was not a concern, and aligning to the cash-based nature of the charity was considered positive. Those with significant investments, thought accruals accounts were a better fit:

> *"I definitely was an accountant who has always thought accrued accounts were proper accounts…actually I think receipts and payments would actually have shown more clearly that the core activities of the charity are actually struggling financially and that's what they need to focus on."* (C2)
>
> *"Receipts and payments is not really suitable for our investments."* (C1)
>
> *"I don't think investments sit very comfortably in a receipts and payments format…given the significance of our investments."* (C3)

5. Discussion and conclusion

This study set out to investigate how widely R&P accounting is favoured and what drives that decision, providing some rationale on the choice adopted. The following conclusions can be drawn from the study in the light of the literature.

Of the 90 sets of accounts considered from a population of 97, 39% were on the R&P basis. This proportion is increased to almost 50% for charities relying on individual donations and community fundraising. R&P accounting was also more commonly found at lower income levels (45% where average income is less than £150,000), or where a charity has been more recently established (60%). Although accruals accounting is the dominant approach in this sample as a whole, it shows a certain appetite for the R&P approach, particularly bearing in mind that the R&P threshold was only increased to include these charities in 2011.

Knowledge and understanding of charity accounting legislation, whether from informed treasurers or the influence of the independent examiner, individual perceptions and experience shape the reporting choice, consistent with findings from Cordery and Sim (2014). Most of the accounts reviewed were on the accruals basis; which some interviewees considered to present a more comprehensive picture, although the concepts underpinning the true and fair view were not specifically driving the reporting choice. There was a consensus that practical factors, for example, simplicity of preparation, particularly considering the new charities SORP, and aligning with cash-based management information, tended toward the R&P approach (consistent with the findings of Cordery et al., 2019; Cordery & Sim, 2014; Crawford et al., 2014; Morgan, 2008).

Perhaps surprisingly, costs to prepare the accounts were not considered a driving factor in the choice of approach, despite the findings in Part 1 of the study that R&P typically attracted a much lower external scrutiny fee, and the literature advocating the cash-based approach as cost-effective (e.g. Crawford et al., 2014). This suggests that other factors driving the reporting choice take precedence over the cost-constraints of the smaller charity.

Most interviewees emphasized the necessity to discharge accountability by reporting appropriately and coherently, justifying the level of trust placed on both the charity and the individual responsible for finances, concurring with the literature (e.g. Connolly & Hyndman, 2000, 2003, 2013; Crawford et al. 2018; Hyndman & McMahon, 2010, 2011; Morgan & Fletcher, 2013; Palmer et al., 2001; Ryan et al., 2014). Consequently, addressing the needs of the stakeholder to whom that accountability is owed is perhaps the most important driving factor in choice of approach. Those charities delivering services commissioned by the public sector, in particular with the aspiration to grow (for example in the social care field) appear more likely to adopt accruals accounting, possibly driven by the perception large grant funders and statutory funders prefer accruals accounts (Morgan, 2008), or by the desire to present a more professional approach. This supports the findings by Cordery and Sim (2014) that resource dependency drives the reporting choice. On the other hand, the more community-focused charities, relying on individual giving are equally as likely to adopt R&P or accruals accounting. Whichever approach, there was agreement that information presented to the trustees and wider membership should be simple to understand and relevant for managing the charity (e.g. Irvine, 2011).

The discussion of the driving rationale ultimately indicates merits in both accounting approaches, but in policy terms we conclude that each charity must decide the best fit to its circumstances. Pressures placed on small charities (compliance with accounting and employment regulation) add extra administrative duties on staff, volunteers and limited resources. Yet, this study has shown that there is appetite to meet their responsibilities, to prove that small organisations are professionally managed, concurring with views in the literature regarding legitimacy theory (e.g. Breen et al. 2018; Hyndman & McConville, 2018). Although the accruals and SORP approach to charity accounting may be perceived as the ‘best’ approach (e.g. Cordery et al., 2019; Hyndman & McMahon, 2010) charities can demonstrate legitimacy though either accruals or R&P accounts: there was no evidence from the interviews of charities producing R&P accounts being less concerned about legitimacy.

Despite an abundance of research on charity accounting and accountability, there have, to date, been only a few studies focusing on the smaller charity and the R&P basis, notwithstanding the vast number of organisations falling in this category. This study, although limited in scope as to the number of charities consulted, their income levels and specific to Scotland, has determined that R&P accounts are being widely used in charities with income up to £250,000. This has implications for practice as those involved in preparing charity accounts advocate the merits that R&P accounts deliver, particularly under the prescriptive Scottish regulations, and especially considering the requirements under the Charity SORP FRS102.

Although some stakeholders may consider accruals accounts as more acceptable, R&P accounts are clearly a legitimate vehicle for discharging accountability and a number of participants considered them more understandable for the average user. The robust framework under the Scottish Regulations for the R&P regime, provides no reason for policy makers to prefer the accruals/SORP approach for smaller charities. This study demonstrates that R&P accounting is a credible choice, used by 39% of sampled charities in the £100,000-£250,000 band, with a wide range of potential drivers to justify its use.

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Table 1: ***A Summary of Form of Accounts and Scrutiny Requirements Based on The Charities Accounts (Scotland) Regulations 2006 as amended***

<table>
<tr><th>Charity Income Thresholds & Legal Form</th><th>Form of Accounts</th><th>Minimum Scrutiny level of Accounts</th></tr>
<tr><td rowspan="2">£0 - £250,000
(non-company charity)</td><td rowspan="2">Receipts & Payments
OR
Accruals</td><td>Independent Examination
(requisite experience & ability)</td></tr>
<tr><td>Independent Examination
(professionally qualified)</td></tr>
<tr><td>£250,000 - £500,000
(non-company charity)
OR
£0 - £500,000
(company charity)</td><td>Accruals</td><td>Independent Examination
(professionally qualified)</td></tr>
<tr><td>£500,000 +</td><td>Accruals</td><td>Audit</td></tr>
</table>

Table 2: Summary data extracted from OSCR Register (17 November 2016) on the 97 charities considered

Charities on OSCR Register:	Number of Charities	Proportion of Total
In Total	24,074	100.0%
With Income less than £250k	19,449	80.8%
With income £100k-£250k	2,060	8.6%
With income £100k-£250k and within selected local authority areas	166	0.7%
Of which non-company Charities selected as final population	97	0.4%

Table 3: Analysis of results by characteristic; numbers of charities

ANALYSIS BY:	R&P	Accruals	Hybrid	Total
Constitutional Form				
Unincorporated Association	22	27	4	53
SCIO	10	10		20
Trust	2	11		13
Other	1	3		4
	35	51	4	90
Charity Type				
Church & faith groups	20	21		41
Social Care	6	13	3	22
Leisure & community	6	7		13
Grant making	2	6	1	9
Heritage	1	4		5
	35	51	4	90
Main funding stream				
Local authority or government	1	6		7
Fees/trading	4	6	2	12
Voluntary or community fundraising	22	23		45
Grant	7	11	2	20
Investment	1	5		6
	35	51	4	90
Average income band (since 2012)				
Under £100,000	12	7	3	22
£100,000-£149,999	17	26		43
£150,000-£199,999	5	5	1	11
£200,000-£249,999	1	8		9
Over £250,000		5		5
	35	51	4	90
IE/Auditor type				
Firm	13	32		45
Individual	10	10	1	21
Redacted information	8	9	3	20
No information given	4	0		4
	35	51	4	90
IE/Auditor qualification				
Professional qualification	16	42		58
None Stated	12	0	1	13
Redacted information	7	9	3	19
	35	51	4	90
Fees charged				
Nil or no fee noted	23	10		33
Under £200	4	2	1	7
£201-£500	3	11	2	16
£500-£1,000	4	12	1	17
Over £1,000	1	16		17
	35	51	4	90
Fees charged per £10,000 income				
Nil	23	10		33
Under £25	5	9	1	15
£25-£50	4	7	3	14
£50-£75	3	9		
£75-£100		3		3
£100-£150		9		9
Over £150		4		4
	35	51	4	90

Table 4: Profile of charities and respondents selected for interview

Ref. for analysis	Charity characteristics						Interviewee Information			
	Legal Form	Approx income	Charity type	Accounts Basis	Main income	IE type	Response	Participant	Accountant	Length in post
C1	Unincorporated association	£115k	Church & Faith	R&P	Donations	Qualified (Individual)	Interview	Treasurer	Retired Chartered Accountant	7 yrs
C2	SCIO	£215k	Social Care	Accruals	Grants	Qualified (Individual)	Interview	Treasurer	Retired Chartered Accountant	8 yrs
C3	Unincorporated association	£110k	Church & Faith	Accruals	Donations, legacy, fees	Qualified (Individual)	Interview	Treasurer	Chartered Accountant	13 yrs
C4	SCIO	£100k	Social Care	Accruals	Grants, donations	Qualified (Firm)	Interview	Chief Executive	No	17 yrs
C5	Unincorporated association	£125k	Social Care	Accruals	Grants, fees	Qualified (Firm)	Interview	Employee including finance	Finance background	14 yrs
C6	Unincorporated association	£170k	Church & Faith	R&P	Donations	Redacted	Interview	Treasurer	Non-qualified accountant	15 yrs
C7	Unincorporated association	£100k	Church & Faith	Accruals	Donations, legacy, fees	Qualified (Firm)	Interview	Treasurer	No	7 yrs
C8	Unincorporated association	£120k	Leisure & Community	R&P	Grants, trading	No info	Email response	Chief Executive	No	Not given
C9	SCIO	£105k	Heritage	R&P	Donations, fundraising	Qualified (Firm)	Email response	Treasurer	Chartered Accountant	Not given
C10	SCIO	£150k	Social Care	Accruals	Grants, fees	Qualified (Firm)	Email response	Chief Executive	No	Not given

Table 5: Semi-structured interview schedule used

	Research question guide
1	What the charity is established to achieve?
2	How long has your charity been operating, have you been involved?
3	Describe any income changes?
4	What is your role in the charity?
5	Is finance/accounting in your background?
6	Describe your involvement in the accounting process?
7	Do you or IE prepare accounts?
8	Are you aware of the choice to prepare R&P or accruals accounts?
9	Are you aware the income threshold for R&P accounts increased from £100k to £250k in 2011, did this impact your choice of accounts?
10	Your accounts are in X approach, what are the reasons for this?
11	Would it be easier for your charity to produce R&P accounts, why?
12	Would it be more cost effective to produce R&P accounts, why?
13	Which accounts better reflect the position of your charity?
14	Which approach is easier to understand for various stakeholders?

[1] E.g. The Charities Act 2011 (England and Wales) and the Charities and Trustee Investment (Scotland) Act 2005.
[2] Although this research is focussed on Scottish Charities, under the guidance of OSCR, it is deemed relevant to consider Charity Commission literature where appropriate.
[3] For the latest version of the Charities SORP, see Charity Commission & OSCR (2014).
[4] Charities and Trustee Investment (Scotland) Act 2005 s44(1).
[5] The Charities Accounts (Scotland) Regulations 2006 s8&9.
[6] FRS102 "The Financial Reporting Standard Applicable in the UK and Republic of Ireland" is a single coherent reporting standard, based on international financial reporting, replacing previous UK accounting and reporting standards.
[7] SCIO (Scottish Charitable Incorporated Organisation) is a legal form for charities requiring benefits of incorporation without obligations of a charitable company.
[8] Schedule 3 of the Charities Accounts (Scotland) Regulations 2006 prescribes, for example, the specific categories that must be used in analysis of receipts and payments, the requirement to distinguish between unrestricted, restricted and endowment funds, and the information required on the statement of balances. By contrast, in England and Wales, the Charities Act 2011 s.133 simply states that R&P accounts are to comprise a "receipts and payments accounts and a statement of assets and liabilities" with no provision for regulations on the content of these statements. This is also the requirement in s.64 of the Charities Act (Northern Ireland) 2008.
[9] For example, CC16b receipts and Payments Accounts Introductory Notes.
[10] Charities and Trustee Investment (Scotland) Act 2005, ss. 7&8.
[11] The simpler Charities SORP FRSSE was also available at this time but has since been withdrawn.
[12] Questionnaires in that study were sent to 559 members of the Association of Charity Independent Examiners of which 240 (42.9%) replied, and 353 grant making trusts in membership of Association of Charitable Foundations, of which 24 (6.8%) replied.

[13] The Charities Accounts (Scotland) Regulations 2006 and subsequent amendments in 2010

[14] OSCR requires annual filing of a return and accounts for all charities (OSCR 2016c); since 1 April 2016 certain accounts are accessible directly from the OSCR website.

[15] Accounts determined as “Hybrid” showed some elements of both R&P and accruals accounts, as it was unclear which approach they intended to follow, they form a separate category to inform the research.

[16] Excluding charities structured as companies which were not included, as explained.

[17] Charities and Trustee Investment (Scotland) Act 2005.

[18] No month of change shown on OSCR record.

[19] There is a requirement to disclose independent examination fees in the annual accounts, where none are identifiable, assumed to be £nil.

[20] The accounts reviewed in Part 1 straddled the implementation date of the new Charities SORP.

[21] For one year from 2015 an alternative Charities SORP based on the Financial Reporting Standard for Smaller Entities was also available (as an alternative to the Charities SORP FRS102) but is now withdrawn.

[22] In line with Accounts Monitoring Review in E&W (Charity Commission 2017b).