

# Paxton



# Paxton Charities Accounting Software

The differences between  
commercial and charity accounting

## INTRODUCTION

According to the Charities Act 2011, “charity” refers to any institution that is “established for charitable purposes only”. These purposes must be “for the public benefit” and we all know that this definition can vary widely: from the prevention or relief of poverty, to the advancement of the arts, to the promotion of equality and diversity.

Therefore, the main difference between the third sector and the private sector is that charities exist to aid a specific cause, while the goal of commercial organisations is to create a profit for their shareholders. So it is perhaps unsurprising that the accounting requirements for each are distinct. The Charity Commission regulates all registered charities in England and Wales. Charitable organisations are subject to tax relief and, accordingly, they face intense scrutiny and are expected to adhere to specific and rigorous standards. Transparency is absolutely crucial. In this eBook, we will explore three key ways in which charity accounting differs from commercial accounting. And we will consider how charities can meet these particular requirements.

“Before using Paxton, we were using paper books. We decided to buy Paxton after reviewing the market and recommendations from existing users. Since moving to Paxton, we have much better analysis. We have reduced our paperwork, and no longer need to analyse the accounts manually.”

**Trustee Peter  
Laurie The Bridge Trust**



# THE DIFFERENCES

## Multiple Funds

One of the key differences between commercial accounting and charity accounting is the necessity for charitable organisations to keep track of multiple funds. Monies raised for a specific purpose, for example a special programme or event, need to be seen to be used for that objective. Therefore, you need to “ring-fence” those monies in dedicated funds within your accounting procedures.

These types of funds are referred to as “restricted funds” in charity accounting parlance. Restricted funds can be either income funds or endowment funds. You can also have unrestricted funds, which can be used for any charitable purpose. Therefore, it is important to keep track of each individual fund, while also maintaining a record of your organisation’s overall financial position.

The Charity Commission requires charities to report on each of its funds, detailing where the monies came from and what they were spent on. And proper multi-fund accounting can be vital when bidding for grants.

By contrast, a commercial organisation will have a general ledger, which is a complete record of all financial transactions and is self-balancing.

## Charity Commission reporting

All registered charities in England and Wales must submit an annual return to the Charity Commission. The return must include three key parts:

- A trustees’ report
- Statements outlining your organisation’s year-end financial position
- Notes providing further explanation for those statements

The accounting methodologies that should be adopted by your organisation are outlined in the Statement of Recommended Practice (SORP), which says: “The proper administration of individual charitable funds is essential if charity trustees are not to act in breach of trust.” These methodologies differ depending upon whether your submission is in accruals or receipts and payments format. The return itself will need to be signed off by an independent examiner or a qualified auditor.

By comparison, a company's annual accounts are called "statutory accounts" and are prepared using the company's financial records at the ends of the financial year. According to GOV.UK, these must be sent to:

- All shareholders
- People who can go to the company's general meetings
- Companies House
- HMRC as part of the Company Tax Return

And they must include:

- A balance sheet
- A profit and loss account
- Notes about the accounts
- A director's report

Unlike a commercial organisation, charities do not measure their success by revenue and profit margins. According to Sayer Vincent, a firm of chartered accountants: "The profit concept is not appropriate to charities, as charity law requires them to use all funds to further the charitable objects. The profit and loss account (income and expenditure account) is therefore replaced by a statement of financial activities (SOFA)." The SOFA shows all income and expenditure for the year across every fund. If you use the accruals accounting method, you must submit your SOFA in your annual return to the Charity Commission, along with your Balance Sheet. However, if you use the receipts and payments method, you must instead submit your Receipts and Payments Report and Statement of Assets and Liabilities.

In both cases, these statements show the total revenue split between the various fund types (unrestricted, restricted and endowment). If proper funds accounting has not been maintained, it can be very difficult and time-consuming to work out the totals for each fund.

Additionally, the SORP requires charities to submit an annual trustees' report, which outlines what your organisation had planned for the year and how closely what you actually did reflects that. Therefore, your organisation will measure its success in terms of what you do, how you do it— and, perhaps most importantly, what you achieve as a result.

The Charity Commission website has full details on the recommended layout and content of each return

## CONCLUSION

Charity accounting involves very specific procedures that need to be carried out correctly. The major delineating factor between the third sector and the private sector is that the former serves the public benefit, while the latter serves shareholders.

While both sectors are expected to be accountable, charities hold a unique position in society and, notably, are eligible for tax relief. As a result, they are expected to be entirely transparent and to keep their finances in check.

Multiple funds, Charity Commission reporting, and donations and Gift Aid are three areas that are specific to charity accounting. As a result, it's well worth investing in a charity-specific accounting package. This solution will give you the peace of mind that your accounts are accurate and up to date, allowing you to focus on furthering the worthwhile work of your organisation.



# PRICES & FEATURES

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	STANDARD	PRO
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Budgets	✓	✓
Donations and Gift Aid	✓	✓
Receipts and payments	✓	✓
Accruals accounting	✓	✓
Charity Commission reports	✓	✓
VAT processing & MTD	✓	✓
Help module	✓	✓
Set up guide	✓	✓
Reports	✓	✓
Sales ledger		✓
Invoicing and price file		✓
Foreign currency		✓
Project analysis		✓
Project budgets		✓



## ABOUT PAXTON

Paxton has been developing software solutions for the public, private and not-for-profit sectors since it was formed in 1979.

We provide the only end-to-end accounting and bookkeeping solution for charities and churches in the UK. We have earned a reputation with our customers for producing highly functional, quality accounting software for professional use.

For many years, Paxton has provided the standard accounting software for the messes, clubs and service funds within The British Army and The Royal Marines. Paxton is an approved developer of software for HM Government.

Call us on 01234 216666 to talk through your charity accounting challenges or to discuss any of the points raised in this guide. We would love to hear from you.

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