

Exposure Draft Practice Note 11: *The audit of charities in the United Kingdom*

# **response to exposure draft**

24 August 2017

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As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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Kate Acott  
Financial Reporting Council  
8th Floor  
125 London Wall  
London  
EC2Y 5AS

Submitted electronically to  
AAT@frc.org.uk  
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Dear Kate

**Exposure Draft Practice Note 11: *The audit of charities in the United Kingdom***

CIPFA is pleased to present its comments on this Exposure Draft, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

Our comments on the content of the ED are provided in attached annexes.

I hope this is a helpful contribution to the development of this guidance. If you have any questions about this response, please contact Steven Cain (e: [steven.cain@cipfa.org](mailto:steven.cain@cipfa.org), t: +44(0)20 7543 5794).

Yours sincerely

Alison Scott  
Head of Standards and Financial Reporting  
CIPFA  
77 Mansell Street, London E1 8AN  
t: +44(0)1604 889451  
e: [alison.scott@cipfa.org](mailto:alison.scott@cipfa.org)

## RESPONSE TO QUESTIONS IN THE INVITATION TO COMMENT

**Q1 Overall do you agree with the proposed revisions to the Practice Note? If not, please explain why.**

Generally, we agree with the proposed revisions, but we have some drafting comments and observations, which are attached at Annex 2.

**Q2 Is the included guidance appropriate? If you believe it should be amended, please explain why and how.**

Generally we consider that the included guidance is appropriate.  
A small number of possible improvements are suggested at Annex 2.

**Q3 Has any extant guidance been deleted that you believe should be retained? If yes, please explain why it should be retained and whether, and if so how, it should be updated.**

Generally we are content with the deletions made.  
A small number of possible improvements are suggested at Annex 2.

**Q4 Are there any other matters in relation to the audit of charities that you believe should be covered in the Practice Note and, if so, what do you believe the guidance should address?**

We have not noted any deficiencies or areas where additional guidance would be required or helpful.

## DRAFTING COMMENTS AND SUGGESTIONS

### 1. General comment on drafting convention

The proposed revised PN11 follows a longstanding drafting convention used in Practice Notes issued by former FRC bodies and predecessor organisations. We believe the intention is that for those actions which the auditor is required to carry out as proper practice in accordance with ISAs, the Practice Note simply states that 'the auditor does X' when the full meaning is that 'the auditor must do X' or 'the auditor needs to do X'.

This slightly coded approach can distract the reader and interrupt the logical flow of the guidance. This is especially true where there are other explicit statements in the sector specific guidance which state that the auditor must / may / or needs to do something. Additionally, in some cases a potential lack of clarity has been addressed by not following the convention. As far as we can tell, there is no consistent approach on when *not* to follow the convention, either within individual Practice Notes, or when compared to similar material in other Practice Notes.

In some cases where the convention has been followed, the result is particularly opaque: some references in PN 11 only make sense if the expanded 'auditor needs to do X' text is considered. See points 5 and 6 below.

We can see that the drafting convention does make the Practice Note less repetitive and more compact. However, given the other measures taken to reduce the length of the document, we suggest that clarity rather than brevity should be favoured.

CIPFA suggests that the FRC might wish to review the use of this drafting convention.

### 2. Approach to removing/retaining quoted ISA material

The approach taken to reducing duplication taken in the proposed revised Practice Note 11 differs slightly from that taken in the recently revised Practice Note 10.

The proposed revised Practice Note 11 removes ISA text, but includes shaded material based on the introductory sentences of the ISA, generally in the format

*[ISA number] deals with [ISA title]*

or

*[ISA number] deals with [ISA title] in the context of an audit of financial statements.*

We did not find this material helpful – it adds almost nothing to what is already expressed in the ISA title.

The revised Practice Note 10 took a different approach to reducing the level of quoted ISA material: it contains short excerpts of the ISA objectives and sector interpretations, shown as shaded material. We found this approach much more helpful. Repeating the ISA objectives provides useful context for sector specific elaboration of how those objectives should be achieved.

CIPFA suggests that the approach taken in Practice Note 10 (quoting the objectives of the standard) is more helpful, and PN 11 would be improved by following it.

### 3. Omission of ISQC1 (Preface, and interpretation of standards)

ISQC1 is not included in the scope of the Practice Note. The introductory paragraphs of the Preface are shown below and refer only to ISAs.

*This Practice Note contains guidance on the application of auditing standards issued by the Financial Reporting Council (FRC) to the audit of financial statements of charities in the United Kingdom.*

*The Practice Note is intended to assist auditors in applying the requirements of, and should be read in conjunction with, International Standards on Auditing (UK) (ISAs UK), which apply to audits of financial statements for periods commencing on or after 17 June 2016. This Practice Note sets out the special considerations relating to the audit of charities which arise from individual ISAs (UK).*

Now strictly speaking, this may correctly reflect the scope of Practice Notes as described in para 13 of FRC *Scope and Authority of Audit and Assurance Pronouncements (2016)*, which refers only to engagement standards, without reference to wider quality control. However, we do not consider that this is the most helpful approach, given that audit firms which conduct multiple audits in a sector may follow the requirements in ISQC1 to develop overarching policies for quality control in that sector, which may differ in detail from that applied to audits of other classes of entity.

The ED Practice Note already references ISQC1, in connection with the factors relevant to determining whether engagements should be subject to Engagement Quality Control Review. This is currently placed in the material on ISA 220; while it refers to ISA 200 para 19, it also references ISQC1 and the actual guidance seems mainly to relate to ISQC1. We suggest that for an audit firm which carries out more than one charity audit, this material informs firm level quality control policies rather than purely reflecting considerations at the engagement level.

CIPFA suggests that it would be better if the Practice Note mentioned ISQC1 in the preface, and provided specific guidance on ISQC1, based on the material currently provided in relation to ISA 220 para 19.

### 4. Drafting suggestion 1 (Page 6 para 13)

Para 13 describes the applicable reporting for smaller charities without mentioning the reporting for larger charities, which from the perspective of the PN is identical.

There are slight differences in the reporting options available to smaller charities under FRS 102, which are specified in the Charity SORP. But if these need to be mentioned, we suggest this would be better done in para 14.

CIPFA suggests the following revised text would be more complete and accurate.

*UK GAAP comprises law and accounting standards issued by the FRC. Charities cannot apply International Financial Reporting Standards. ~~Smaller~~ All charities preparing 'true and fair' accounts are ~~now~~ required to apply the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102).*

## 5. Drafting suggestion 2 (Page 12 para 35)

The drafting of para 35 is awkward and perhaps unclear: it is quite difficult to identify what 'presumption' is being referred to in the second sentence.

*The auditor remains aware that, although charities are not profit-making entities, there is still a risk of material misstatement due to fraudulent financial reporting relating to income recognition. This presumption may not always be appropriate for some public sector bodies which are funded from central government directly by grant-in-aid income where reporting on expenditure and outcomes is also required.*

This could be addressed by redrafting the first sentence in a more direct style, or by replacing 'This presumption' in the second sentence with

'The presumption that the auditor needs to remain aware of fraud risk'

## 6. Drafting suggestion 3 (Page 23 para 104)

The second sentence of para 69 reads rather awkwardly and may be unclear

*ISA (UK) 260 (Revised June 2016) stresses that communication shall be active, two way communication between the auditor and those charged with governance. Because charity trustees represent a wider range of skills and experience than may be found in the commercial sector, the auditor particularly ensures that the auditor's communications are understandable and clear.*

CIPFA suggests amending the second sentence as follows:

*Because charity trustees represent a wider range of skills and experience than may be found in the commercial sector, the auditor needs to take particular ~~ly~~ care to ensures that the auditor's communications are understandable and clear.*

## 7. Drafting suggestion 3 (Page 23 para 104)

*Many charities receive funds subject to specific trusts, which must be accounted for separately (unless grouped together if, individually, they are comparatively small) in accordance with the Charities SORP. There is no presumption that the auditor will set a different monetary materiality level for such funds.*

The first sentence of this paragraph is difficult to read. Also, while it echoes the wording in the SORP, it does not provide the full context. On balance, we think it would be better not to mention trusts. The key matter is that charities sometimes have to report on restricted funds separately: that is, when they are the subject of a specific trust from the perspective of charity law. Otherwise separate reporting is not required. The charity and their auditors need to have regard to the legal position and then the Charity SORP.

CIPFA suggests replacing the first sentence with the following:

*Many charities receive funds which are subject to restrictions. In some cases these must be reported separately in accordance with the Charities SORP.*