

November 2017

Feedback Statement and Impact Assessment

The Revision of Practice Note 11: The audit of charities in the United Kingdom

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FEEDBACK STATEMENT AND IMPACT ASSESSMENT

Practice Note 11—*The audit of charities in the United Kingdom*

Introduction

The FRC is committed to acting as a proportionate and principles-based regulator, and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.

We proposed revisions to *Practice Note 11: The audit of charities in the United Kingdom* (PN 11) resulting from the following drivers:

- Revisions to International Standards on Auditing (UK) (ISAs (UK));
- Changes to UK accounting standards (FRS 102) and the revision of the Charities SORP;
- Continuing developments in regulation and guidance issued by the UK Charity Regulators; and
- Changes in relevant legislation.

Our proposed revisions to PN 11, designed to address the above drivers, were drafted in consultation with an expert working group led by FRC staff and including representation from audit firms, the UK Charity Regulators, Professional Bodies and other stakeholders.

The FRC consulted publicly on the proposals, and the consultation closed on Friday 25 August 2017. In addition we conducted targeted additional outreach, speaking to smaller audit firms and other stakeholders who would have an interest in the financial statements of charities, to identify the issues in which they had the greatest interest and the impact of PN 11 on audits of charities.

Responses to the Invitation to Comment

We received 20 responses – 3 from Professional Bodies (PB), 14 from Audit Firms (AF), 1 joint response from the UK Charity Regulators (CR) and 2 from Other Stakeholders representing charities' interests (OS). A list of the respondents is included in Appendix 1 to this Feedback Statement and Impact Assessment. In line with the FRC's commitment to transparency these responses are published on our website.¹

In the rest of this Feedback Statement we set out a summary of the responses received to each question, along with the FRC's response.

¹ <https://www.frc.org.uk/consultation-list/2017/invitation-to-comment-proposal-to-revise-pn-11-t>

Summary of responses to the questions in the Invitation to Comment

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

17 respondents (13 AF; 3 PB; 1 CR; 1 OS) supported the proposed revisions to the Practice Note.

Two respondents (2 AF) supported the revisions to the Practice Note with the exception of the guidance included in the section of ISA (UK) 720 (Revised) which they did not agree with. One respondent disagreed with the guidance in the PN and argued that the trustees' report for charities that are not companies does not meet the definition of 'statutory other information'. The other respondent argued that, although the Charities SORP contains provisions relating to the preparation by charities of trustees' reports and financial statements, these two elements have different legal status, as neither Charity nor Company law or Regulations require charities to follow the SORP when preparing the trustees' report.

FRC Response

Whether the trustees' report is statutory other information

ISA (UK) 720 (Revised June 2016) defines statutory other information as "those documents or reports that are required to be prepared and issued by the entity (including any report or documents that are incorporated by cross reference) in relation to which the auditor is required to report publicly in accordance with law or regulation". As explained in the PN, legislation requires auditors of both charitable companies and non-company charities to report on the consistency of the information given in the trustees' report with the financial statements. Accordingly, the trustees' report is statutory other information, and as such requirements 12-1, 14-1 and 14-2 of the ISA (UK) apply to all charities.

Whether the auditor is required to consider whether the trustees' report has been prepared in accordance with the Charities SORP

The legal requirements for the content of the trustees' report are set out in the underlying Regulations to the Charities Acts.²

In England and Wales, and Northern Ireland, the Regulations do not specifically require the trustees' report to be prepared in accordance with the Charities SORP. In Scotland, the relevant Regulations require the charity to prepare a "statement of account" which includes an annual report. The statement of account is required to be prepared in accordance with the methods and principles set out in the Charities SORP.

However, the Charities SORP states in paragraph 25: "*For a charity to state that it has prepared its accounts in accordance with this SORP, it must adhere to the SORP's requirements for the preparation of both the accounts and report.*"

Therefore, when considering whether the trustees' report has been prepared in accordance with the legal and regulatory requirements applicable to the statutory other information, the auditor considers both the legal requirements and the mandatory requirements of Module 1 of the Charities SORP.

² In England and Wales: The Charities (Accounts and Reports) Regulations 2008; in Scotland: The Charities Accounts (Scotland) Regulations 2006; and in Northern Ireland: The Charities (Accounts and Reports) Regulations (Northern Ireland) 2015.

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

Three respondents (3 AF) stated that the guidance was appropriate, with a further 5 (4 AF; 1 PB) stating that it was appropriate but identified some areas where they believed it could be further improved. Two respondents (2 AF) stated that the guidance was appropriate with the exception of the guidance on ISA (UK) 720 as noted above.

Many of the respondents gave helpful editorial suggestions and identified points of detail specific to particular sections. Particular issues identified by respondents (but in no cases a majority) included guidance on:

- Why the conditions and events in Appendix 1 could give rise to a risk of material misstatement.
- Auditing related parties in a charity.
- Gift aid distributions.
- Reporting matters of material significance to charity regulators.
- The audit of opening balances.

FRC Response

Editorial suggestions were welcomed, particularly those that aided clarity, and have been reflected where considered appropriate.

Appendix 1 conditions and events

Appendix 1 is a new addition which pulls together the conditions and events that may indicate risks of material misstatement which were previously interspersed through the PN, which may be of particular relevance to charities. The introductory paragraph to the Appendix clearly states that not all conditions and event are relevant to every audit engagement. Four respondents (4 AF) requested that additional guidance be included to explain why these may indicate risks of material misstatement. However, the FRC believes that it is not appropriate to explain how these events and conditions may give rise to a risk of material misstatement as these will vary depending on the particular circumstances of that charity. This judgment is for the auditor to make.

Related parties

Several respondents (3 AF; 1 PB) requested additional guidance on how to audit related parties, including how the auditor should obtain an understanding on the charity's related party relationships and transactions. One respondent (1 AF) highlighted that this was a challenge as trustees and management were reluctant to provide details of their close family and other interests. However, three respondents (2 OS; 1 CR) expressed concern about inconsistent practices between auditors regarding communication with the trustees in disclosing related parties and related party transactions, particularly in respect of written representations.

The FRC considered this matter in some depth with the expert working group and concluded that no additional guidance was required as this was not a matter unique to the charity sector. The auditor needs to ensure that they meet the requirements of ISA (UK) 550 (Revised June 2016), including obtaining written representations from management and, where appropriate, those charged with governance. Application material to the ISA (UK) sets out guidance about

when it may be appropriate to obtain written representations from those charged with governance.³

Gift aid distributions

Two respondents (2 AF) requested guidance on the treatment of gift aid donations of profits from trading subsidiaries to parent charities. However, this is predominantly a question of accounting treatment rather than one of auditing. Since the consultation was published, the FRC has issued FRED 68⁴ to consult on the proposed changes to FRS 102 to account for payments by subsidiaries to their charitable parents that qualify for gift aid. The FRC does therefore not consider it necessary to include any auditing guidance in this PN given the proposed clarification of the appropriate accounting treatment.

Reporting matters of material significance to charity regulators

The Charity Regulators have issued guidance on the auditor's responsibility to report matters of material significance to UK charity regulators⁵ and this includes a full list of the circumstances in which an auditor needs to report to the relevant charity regulator. The FRC sees little merit in replicating this list in this PN and believes that a cross-reference to the material will encourage auditors to read the guidance in full.

Opening balances

In their joint response, the Charity Regulators expressed a concern that for accounts filed in 2016, a proportion of the auditor's reports for initial audit engagements included an emphasis of matter or was modified. Their response notes:

"In relation to carry forward balances in the case of eight charities, the lack of evidence was due to either a change in auditor since the previous year or because the previous year's accounts did not require an audit... In eight cases charities had material amounts of stock and their auditors did not attend the year end stock count, either because they had not been informed it was material or because they were appointed after the stock count had been held... [In] the case of six charities, the auditor was unable to confirm whether all income that was due to the charity had been included in the charity's accounting records, either because records had not been kept or because the charity relied on voluntary donations."

Whilst the FRC recognises that the comments made by the Charity Regulators are valid, they are not charity specific as such matters are common to initial audit engagements for all entities.

Practice Notes are intended to assist auditors in applying the ISAs (UK) and should be read in conjunction with the ISAs (UK). They are not intended to be "how to" manuals for an audit. The FRC believes that the charity specific guidance provided in paragraphs 136–139 of the PN, combined with the requirements and application material in ISA (UK) 510,⁶ is sufficient to assist the auditor to meet their responsibilities relating to opening balances in an initial audit engagement.

³ ISA (UK) 550 (Revised June 2016) *Related Parties*, paragraph A48–A49-1.

⁴ [FRED 68 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland Payments by subsidiaries to their charitable parents that qualify for gift aid \(September 2017\)](#).

⁵ [Matters of Material Significance reportable to UK charity regulators: A guide for auditors and independent examiners](#).

⁶ ISA (UK) 510 (Revised June 2016) Initial Audit Engagements—Opening Balances.

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.

Most respondents supported the FRC's proposals to streamline the Practice Note by omitting material that is repeated in the relevant ISA (UK) itself and removing guidance and other material that an auditor would be able to find elsewhere. Three respondents (2 AF; 1 PB) encouraged the FRC to make the online version of the Practice Note more interactive through the use of hyperlinks.

However, a number of respondents requested the following illustrative examples should be included:

- Auditor's reports for charities (5 AF)
- Statements of trustees' responsibilities (5 AF; 1 PB)
- Paragraphs for insertion into an engagement letter (2 AF; 1 PB)

Three respondents (3 AF) also wanted to see the guidance on Summary Financial Information and Summarised Financial Statements reinstated.

One respondent (1 AF) requested the Special Features of Charities section of the current Practice Note be reinstated on the grounds that the guidance provides useful context and information on the particular issues that may arise on a charity audit. One respondent (1 AF) commented that the guidance on ISA (UK) 520 *Analytical Procedures* which has been deleted remains relevant and useful.

FRC Response

Illustrative examples

The FRC no longer provides an exhaustive range of example auditor's reports for all types of audited entity. We do not, therefore, include a charity example in the PN. The requirements for the content of the auditor's report are clearly set out in ISA (UK) 700. Some illustrative auditor's reports which show how that content can be presented are set out in the *Bulletin: Compendium of illustrative auditor's reports on United Kingdom private sector financial statements for periods commencing on or after 17 June 2016*, which an auditor can refer to and adapt. This is a policy which is being applied in all revised Practice Notes.

Similarly, the FRC does not provide example paragraphs for insertion into an engagement letter.

The trustees' responsibilities in respect of the financial statements will vary depending on the jurisdictional law and the charity itself. The FRC is concerned that any illustrative example statement of trustees' responsibilities may not be appropriately tailored for the individual circumstances of each charity. Accordingly, the FRC has not reinstated these examples.

Summary financial information and summarised financial statements

The requirement for the external scrutineer to give an opinion as to whether or not the summarised financial statements are consistent with the financial statements has been revoked and is no longer within the scope of the Charities SORP. We understand that some charities continue to produce either summarised financial statements or summary financial information and request that their auditor provide an assurance report on such material. However, as there is no longer a legal or regulatory requirement with respect to such information, this guidance has been removed from the Practice Note. A brief note has been

included in the Preface to the new Practice Note to explain that such matters are not covered by the new guidance.

Other

The Special Features of Charities section has been integrated, where appropriate into the relevant ISA (UK) sections, predominantly those sections on ISA (UK) 315, ISA (UK) 330 and ISA (UK) 600.

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?

Summary of Responses

3 respondents (1 AF; 2 PB) requested that the Practice Note include guidance on how the auditor should deal with a specific set of circumstances arising in England and Wales.

FRC Response

Impact on auditor's report of a breach in legal requirement

In England and Wales, the Charities (Accounts and Reports) Regulations 2008 (the 'Regulations') are yet to be updated to refer to the new Charities SORP (FRS 102), and still refer to the 2005 version. Early adoption of a new SORP is not lawful for non-company charities until the applicable Regulations have been updated. However, when UK Generally Accepted Accounting Practice (GAAP) changes, the old SORPs are withdrawn and replaced by new SORPs which apply from the date at which the new GAAP comes into effect; this is the case whether or not the Regulations are updated. The 2005 SORP ceased to apply under UK GAAP for financial years beginning on or after 1 January 2015 because it was withdrawn.

The Charity Commission in England and Wales has provided guidance⁷ which effectively requires preparers of non-company charities' financial statements to depart from the requirement in the Regulations to prepare the financial statements in accordance with the 2005 SORP and instead prepare them in accordance with the new SORP. Provided that the financial statements disclose why a departure from UK GAAP is necessary for the financial statements to give a true and fair view in accordance with the provisions set out in UK GAAP, then the auditor should not need to refer to the matter in the auditor's report. As with any other true and fair override, the auditor would not need to qualify the auditor's opinion for a breach of the relevant law. This will be resolved when the Charities Regulations are updated, however, until then we have drawn attention to this in this feedback statement rather than the Practice Note to avoid the risk of it quickly becoming out of date.

⁷ [Charity reporting and accounting: the essentials November 2016 \(CC15d\)](#)

Conclusion

The FRC will, therefore, following public consultation issue a revised version of *Practice Note 11: The audit of charities in the United Kingdom*.

Adoption of this guidance will assist auditors in the application of auditing standards in a proportionate way to the audit of financial statements of charities, thereby supporting high quality audit.

Impact Assessment

A Practice Note provides guidance to support best practice. Although a Practice Note is not prescriptive, the FRC's Statement on the Scope and Authority of Audit and Assurance Pronouncements states that auditors should be aware of and consider Practice Notes applicable to the engagement. Auditors who do not consider and apply the guidance included in a relevant Practice Note should be prepared to explain how the engagement standards have been complied with. The FRC has completed an impact assessment for the proposed revised PN 11 and has not identified any additional costs resulting from the revised guidance included in the exposure draft.

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Appendix 1: Respondents to the Consultation

Joint response from the UK Charity Regulators:

- Charity Commission for England and Wales (CCEW)
- Charity Commission for Northern Ireland (CCNI)
- Office of the Scottish Charity Regulator (OSCR)

Association of Charitable Foundations (ACF)

BDO LLP

Charity Finance Group (CFG)

Chartered Institute of Public Finance & Accountancy (CIPFA)

Crowe Clark Whitehill LLP

Deloitte LLP

Grant Thornton UK LLP

Institute of Chartered Accountants in England and Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

Johnston Carmichael

Kingston Smith LLP

Kreston Reeves LLP

MHA Macintyre Hudson

Moore Stephens LLP

Price Bailey LLP

PricewaterhouseCoopers LLP

RSM UK Audit LLP

Saffery Champness LLP

Sayer Vincent LLP



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