

May 2017

Invitation to Comment:

Proposal to revise Practice Note 11: The audit of charities in the United Kingdom

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INVITATION TO COMMENT

Proposal to revise Practice Note 11: The audit of charities in the United Kingdom

Objective

The Financial Reporting Council (FRC) proposes, subject to stakeholder views, to issue a revised version of Practice Note 11: *The Audit of charities in the United Kingdom* (PN 11). Practice Notes are intended to assist practitioners to comply with the requirements of standards, by providing additional contextual material on the application of standards in particular circumstances or in specialised sectors.

PN 11 was last updated in 2012 and needs to reflect revisions to UK auditing standards (ISAs (UK)), changes to the legislative and regulatory framework and developments in accounting and audit framework, including the issuance of a new Charities SORP. Charities have also been the subject of extensive press, public and Parliamentary interest of late, and this revision of the Practice Note seeks to incorporate lessons learned.

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 or separately identifiable quantifiable benefits resulting from the revised guidance included in the exposure draft.

Invitation to comment

The FRC is requesting comments on this Invitation to Comment by 5pm on 25 August 2017. Comments are invited in writing on all aspects of the revised Practice Note. In particular, comments are sought in relation to questions 1–4 as discussed below.

Comments should be sent to:

Kate Acott
Project Director
Financial Reporting Council
E-mail: AAT@frc.org.uk

Introduction

- 1. 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.
- 2. In 2016, the FRC commenced a project to consider revisions to Practice Note 11: The Audit of Charities in the United Kingdom (PN 11), which was last updated in 2012. The main drivers for revising PN 11 are:
 - 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 Charity Regulators; and
 - Changes in relevant legislation.

How we revised the Practice Note

- 3. We established an expert working group to support the project to revise PN 11, including representation from audit firms, the Charity regulators, and other stakeholders. The guiding principles followed in reviewing and updating the guidance included:
 - Updating the guidance to address the drivers for revision identified above.
 - Omitting material that is a repeat of what is in the relevant ISA (UK) itself.
 - Removing material that an auditor would be able to find elsewhere, including in guidance issued by the Charity Regulators, accounting standards of the Charities SORP (in most cases replacing with a cross reference).
- 4. Where appropriate, in drafting this Practice Note, we have taken account of relevant reports and feedback, such as the report from the House of Commons Public Administration and Constitutional Affairs Select Committee.¹

Main areas of change

5. The main areas of change we are proposing to extant PN 11 are:

• Legislative and Regulatory Framework: this section has been updated to reflect changes across the different jurisdictions in the United Kingdom. In addition, Appendix 1 (now Appendix 2) – Charity accounting and audit regulations in the United

Kingdom has also been amended and updated to incorporate the material in Appendix 6 – Legislative background to auditor's reports on charities' financial statements.

Reporting matters of material significance to Charity Regulators: a separate section has been included in the PN covering content previously included in ISA (UK) 250 Section B and Appendix 5 – The duty of the auditor to report matters of material significance to CCEW and OSCR. This material has been updated to reflect

Public Administration and Constitutional Affairs Committee, The Collapse of Kids Company: lessons for charity trustees, professional firms, the Charity Commission, and Whitehall (Fourth Report, Session 2015–16, HC 433)

- anticipated changes in the Charity Regulators' guidance on matters of material significance.
- Special features of charities: the material in this section has been incorporated, where relevant, into ISAs (UK) 250, 315, 330 and 600. ISAs (UK) 315 and 330 have been updated to reflect changes in the charity accounting framework and best practice where appropriate. To avoid duplication a new appendix has been inserted into the PN (new Appendix 1 Conditions and events that may indicate risks of material misstatement) which sets out conditions and events which may give rise to a risk of material misstatement specific to charities.
- Materiality: the section on ISA (UK) 320 has been updated to provide further guidance about judgments about materiality and both the size and nature of misstatements.
- **Going concern**: the section on ISA (UK) 570 has been expanded and updated to provide more guidance to auditors.
- Other information: the section on ISA (UK) 720 has been updated to provide guidance on how the revised standard applies to the trustees' report.
- 6. The following sections have been deleted as they either did not have charity specific content or are no longer required:
 - Standards: ISA (UK) 200; ISA (UK) 300; ISA (UK) 505; ISA (UK) 520;
 - Summary financial information and summarised financial statements;²
 - Appendix 2 Publications,
 - Appendix 3 Example paragraphs for insertion into an engagement letter,
 - Appendix 4 Illustrative example statements of trustees' responsibilities;
 - Appendix 5 The duty of the auditor to report matters of material significance to CCEW and OSCR;
 - Appendix 6 Legislative background to auditor's reports on charities' financial statements;
 - Appendix 7 Definitions; Appendix 8 Some significant topics relevant to audits of charities.
- 7. Overall this approach has resulted in a significant shortening of PN 11 from 149 to 71 pages, with an updated and increased focus of guidance on matters specific to the audit of charities and avoiding duplicating material that can be found elsewhere.

Impact Assessment

8. 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.

² The auditor is no longer required to give an opinion on the summarised financial statements.

Questions

- 9. The FRC welcomes comments on all aspects of the revision of PN 11. However, we would specifically encourage views on the following questions:
 - Overall do you agree with the proposed revisions to the Practice Note? If not, please explain why.
 - Q2 Is the included guidance appropriate? If you believe it should be amended, please explain why and how.
 - 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.
 - 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?

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Financial Reporting Council

8th Floor 125 London Wall London EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk