

AUDIT NEWS

INTRODUCTION

Welcome to this brief winter edition of Audit News, where we report The Charity Statement of Recommended Practice (SORP) 2015; going concern considerations in the audit

of charities; and a reminder that 2015 is the final year of the 5 year cycle for the ICAS mandatory course for Audit Compliance Partners (ACPs).

We hope you find this edition of Audit News useful, and we would like to take this opportunity to wish you a very happy break over the holiday period.

THE CHARITY SORP 2015

The Charity Commission and the Office of the Scottish Charity Regulator (OSCR), as the joint SORP-making body for charities, have developed two SORPs, one to support the Financial Reporting Standard for Smaller Entities (FRSSE) and one to support the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102).

For accounting periods starting on or after 1 January 2015, when preparing a charity's accounts on an accruals basis, you must decide whether to prepare the accounts under the FRSSE or FRS 102.

This brief article merely draws your attention to the publication of the new Charity SORPs, and we would advise anyone conducting audits of charities to ensure they undertake appropriate training in this regard.

For further information, including copies of the FRSSE and FRS 102 SORPs, and useful application guidance, please visit the Charity SORP website at: charitiessorp.org/download-a-full-sorp/

Which of the SORPs should I be using?

FRS 102 may be followed by any charity; however, charities following this are required to provide more information in the notes to the accounts and must provide a Statement of Cash-flows, irrespective of their level of income.

Charities currently may only use the FRSSE if they meet 2 of the following 3 criteria:

- Gross income not exceeding £6.5m;
- Gross (total) assets not exceeding £3.26m; and
- Employs no more than 50 staff.

What are the main changes introduced by the new SORPs?

Firms should familiarise themselves with the requirements of the new SORPs, and keep these in mind when conducting such audits of charities. There have been some specific changes to accounting policies and disclosures, and a brief summary of the key changes are noted below:

Income recognition

The most significant change from the previous SORP, is that income should now be recognised when it becomes 'probable' (ie more likely than not), whereas, under the 2005 SORP, income was recognised when it became 'virtually certain'.

The FRS 102 SORP also provides more guidance than the previous SORP on how time related conditions may prevent income recognition; recognising income from legacies, including the use of a portfolio approach for immaterial legacies; and a three point test as to when receipt of a legacy is 'normally probable'.

Auditors need to be aware of this change when considering whether income has been recognised appropriately, considering all sources of income, including donations and legacies, and that the charity's income recognition policy is accurately disclosed in the notes to the accounts.

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Donated goods and services

Whilst the previous SORP required that income from the receipt of donated goods for sale was recognised once sold, the new SORPs require recognition at the point of receipt at fair value (ie when the charity first receives the goods as a gift).

This requirement is only relaxed if it is impractical, or the costs of recognition outweigh the benefit to users of the accounts and the charity. In such instances, the donated goods would then be recognised as income when they are sold or distributed.

An important consideration in this regard will be whether stock and income have been appropriately recognised, and this may include an enhanced review for completeness; discussion with management; and a review of minutes of Trustee meetings.

Employee benefits

Charities must recognise a liability for the cost of all benefits to which employees are entitled at the reporting date that have yet to be paid. Within the FRS 102 SORP there is now a specific requirement to recognise a liability in the balance sheet for any paid annual leave and sick leave entitlement, if material.

This could, potentially, result in an additional liability for the charity, and the auditor should enhance considerations where the holiday year for staff and the charity's financial year do not coincide.

Going concern

Trustees should provide an explanation of factors supporting the conclusion the charity is a going concern. If there are material uncertainties about the charity's ability to continue as a going concern this should be disclosed and, where there are no material uncertainties, this should likewise be stated.

ISA 570 states that the auditor has a responsibility to obtain sufficient appropriate audit evidence about the appropriateness of the Trustees' use of the going concern assumption and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. This will include consideration of the Trustees' disclosures in the financial statements and whether they are accurate.

Related parties

The new SORPs contain a revised definition of related parties and additional disclosures for related-party transactions. In this regard, it is vital to ensure that all Trustees are properly appointed and approved.

In addition, all charities must now either disclose the fact that there were no employees who received remuneration in excess of £60,000 or disclose the number of employees remunerated above £60,000 in bands of £10,000.

The FRS 102 SORP requires a number of additional disclosures which, significantly, includes disclosure of the total amount of employee benefits received by key management personnel.

Other matters to consider

In the experience of ICAS AM, firms using specialist programmes tend to have a greater level of compliance, as the other options require firms to dedicate significant time and resource to ensuring a tailored set of programmes remain up to date. In addition, given the number of new disclosures required in the accounts of a charity, and the new format of the Statement of Financial Activities (SOFA) under the new SORPs, it is recommended that firms utilise an up to date disclosure checklist.

Given the nature of the specialist aspects in the audit of charities, it is important that Responsible Individuals (RIs) and staff who have charity clients remain up to date in this area. In particular, it is crucial that RIs remain up to date with changes in legislation or regulations affecting their clients and this should be demonstrated in their training records.

In addition, firms may also wish to consider the following matters with regard the charity audit clients that they have:

- When a charity client will first need to adopt SORP 2015 (for charities with 31 December year ends, first adoption will be for the period ending 31 December 2015);
- Whether a client's accounting systems will be able to accommodate the changes;
- Whether a client will need specialist assistance to identify transitional issues; and
- Whether clients should obtain valuations for fixed assets that they wish to measure at fair value at the transition date.

It is also worth noting at this stage that the FRSSE is likely to be further reviewed by 2016, which may have implications for the related SORP, resulting in adopters having to review and/or amend their accounting policies twice in quick succession.

We would also like to draw your attention to additional guidance on the ICAS website, including video content, which expands on the areas noted above. This guidance can be accessed at: icas.org.uk/News/Latest-News/The-new-Charities-SORPs-initial-matters-for-consideration/

GOING CONCERN CONSIDERATIONS IN AUDIT OF CHARITIES

As with standard trading entities, for charity accounts to be prepared on a going concern basis, it means that from the date of signing the accounts that the charity will continue to exist or operate on a similar basis for at least a further 12 months from the date that the accounts are approved.

With charities, assessment of the going concern basis can be complicated by uncertainty as to future income streams or funding, in particular where projections or cash flows are based on funding which has yet to be approved or awarded.

IICAS AM receives regular queries in this regard, particularly where there is uncertainty over future income or funding sources.

The first thing to note is that any significant uncertainty must be disclosed in the trustees report, and, if appropriate, in the notes to the financial statements. The trustees are required to be able to demonstrate that the charity will remain a going concern regardless of the uncertainty. It is then the auditor's duty to refer to this in the audit report, and the auditor will be required to obtain sufficient and appropriate evidence to support the disclosure made by the trustees.

What are some examples of procedures that an auditor should consider performing?

Such evidence of the assessment of going concern will include consideration of cash flows; forecasts; and budgets spanning at least one year from the date of signing the audit report. Where audit teams are performing such considerations we would also advise that this is extended to an assessment of the source of the information and the assumptions made by the client in producing these, and that these are corroborated to audit work already performed, or to additional audit procedures required.

In considering projections of income, the auditor should consider the nature of income or funding sources, their regularity and predictability, and the degree of risk attaching to such sources. A number of charities, for example, receive public or local government funding which is often not confirmed until close to the award date, which can cause issues for the auditor in assessing the appropriateness of future budgets and cash flows. In this situation, it is not only important to consider the regularity and predictability of the funding (for example, if the income has been received regularly for a number of years) but also the risk to the

charity, especially where the funding in question represents a significant proportion of the charity's total income.

It is usually necessary to take account of the particular circumstances of that charity which may affect its ability to continue its activities. The auditor should then consider the availability of future funding and whether uncertainties exist which require disclosure in the financial statements. Further, the auditor should document the process followed and how the conclusions have been reached.

When should there also be consideration of the impact on the audit report?

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

If the auditor believes the going concern basis is not appropriate, or that the relevant disclosure given in the accounts is not adequate, then a qualified or, if appropriate, adverse opinion should be expressed.

This could result in issues for the charity in dealing with potential funders who read the accounts, and who may have second thoughts about funding a charity with perceived financial issues. Anything which could be seen as likely to concern stakeholders is clearly not desirable for any charity at any time and trustees are understandably nervous about commenting on going concern or modifications to the audit report. It is therefore important to discuss the issue of going concern with the trustees as soon as practical in the audit process.

It is also important to note, following The Charity SORP 2015 article above, that trustees are required in all cases to provide an explanation of factors supporting the conclusion the charity is a going concern, and if there are material uncertainties about the charity's ability to continue as a going concern these must be disclosed by the trustees.

REMINDER – MANDATORY COURSE FOR AUDIT COMPLIANCE PARTNERS

Keeping Your Audit Firm and Files on the Right Track

As we confirm in each of our Audit News editions, these courses are mandatory for ACPs, however to ensure mandatory attendance is not too onerous, you are required to attend only once every five years, and the courses are still heavily discounted for those requiring mandatory attendance. Courses are developed and delivered by the ICAS Audit Monitoring team and the dates and locations for 2015 are as follows:

- 10 March 2015 – Aberdeen
- 24 June 2015 – Edinburgh
- 30 September 2015 – Glasgow

These courses can be booked via the ICAS website, at: icas.org.uk/Businesscourses/

Please note that 2015 will be the final year of the first 5 year cycle of the mandatory course of ACPs. If you have not yet attended the course, and have been an ACP since the course inception in 2010, you will be required to attend before the end of 2015.

Should you have any questions in this regard please do not hesitate to get in touch with ICAS AM at: auditandpracticemonitoring@icas.org.uk

If you would like to see any particular articles in future editions of Audit News or any particular auditing areas covered in future monitoring helpsheets please send your ideas to: auditandpracticemonitoring@icas.org.uk