



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

**RESPONSE FROM ICAS TO  
THE FINANCIAL REPORTING COUNCIL**

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## **Background**

ICAS is a professional body for more than 21,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business and in the not for profit sector; many leading some of the UK's and the world's great organisations. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

## **General comments**

The ICAS Charities Panel welcomes the opportunity to respond to the FRC's proposal to revise Practice Note 11: The audit of charities in the United Kingdom.

We are supportive of the approach taken to the proposed revised Practice Note 11. The practice note is much more focused while adding value relative to the current version.

We have responded to each of the consultation questions and, in our response to question 2, we provide detailed comments on aspects of the draft practice note.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions, at [cscott@icas.com](mailto:cscott@icas.com)

## Comments on consultation questions

### Question 1

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

We support the FRC's approach to the proposed practice note. In particular, we welcome, the following guidance:

- The much clearer emphasis throughout the practice note on the auditor's work in relation to restricted funds.
- Paragraph 125 on grants payable. The inclusion of reference to using "thank you" letters as third party audit evidence is a valid point and appropriately highlighted in the proposed practice note.
- Paragraph 161. Recognition that failure by a charity to provide public benefit could have an impact on a charity's ability to continue as a going concern and that this should be considered by the auditor as part of their work under ISA (UK) 570.
- Paragraph 167. The suggestion that auditors should request cash flow forecasts which distinguish between restricted and unrestricted funds.

### Question 2

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

### Response

We have the following detailed comments on the text of the proposed practice note:

#### Comments on the structure of the document

We would welcome fully numbered sections to assist internal cross-referencing. Other than the referencing of the appendices which is fine, the other sections are either not numbered or are referenced by ISA (UK) only.

#### Preface

- Footnote 3 on page 2 should include reference to the independent examination guidance published by the Charity Commission for Northern Ireland (ARR07).
- Paragraph 13 refers to all charities, including smaller charities, having to comply with FRS 102 if the accounts are to give a true and fair view. However, we believe that there needs to be recognition within the Practice Note that the Charities (Accounts and Reports) Regulations 2008 (England & Wales), which apply to non-company charities, still refer to SORP 2005 (and hence to old UK GAAP). Guidance in the Practice Note on this topic would be welcomed, for example, how this issue should be addressed in the auditor's report.

#### ISA (UK) 210: Agreeing the terms of the audit engagement

- Paragraph 17. On a technical point, the auditor of a charitable company is appointed by the members rather than the trustees and this could be the case for some non-company charities too. We recognise that in practice the appointment process is likely to be managed by the trustees.

#### ISA (UK) 220: Quality control for an audit of financial statements

- Paragraph 22. We recommend that the self-review threat, set out in bullets 2 and 3, should refer to the situations where the audit firm provides financial administration services to the charity, for example, bookkeeping, payroll, gift aid processing. We understand the auditor can still act if all conditions in the FRC's Ethical Standard are met.

- Paragraph 22. We recommend the following amendment to bullet 3. “Considering whether other relationships exist between a firm and a charity – although the existence of a business relationship is unlikely, if a firm made regular donations or provided material support to a charity, either financially or by allowing a material donation in kind this may be considered to be another relationship as defined in the Ethical Standard, and ~~would~~ MIGHT impact on the auditor’s independence.” We believe that ‘would’ is too definitive a word in this context.
- Paragraph 22. The material in this paragraph should apply to the audit of any charity not just a charitable trust.
- Paragraph 22. A definition of ‘covered person’ should be included, perhaps in a footnote.

### **Charities’ own whistleblowing policies**

- A charity’s own whistleblowing arrangements for staff and beneficiaries to report concerns to management or the trustees and the operation of those arrangements are relevant to the work of the auditor. We recommend that consideration is given to strengthening the material in the sections of the practice note on ISA (UK) 240: The auditor’s responsibilities in relation to fraud, ISA (UK) 250: Section A – Consideration of laws and regulations and ISA (UK) 315: Identifying and assessing risks to emphasise their relevance.

### **ISA (UK) 250: Section A – Consideration of law and regulations in an audit of financial statements**

- Paragraph 43. It may be worth referring specifically to the governing documents (i.e. the constitution) of a charitable incorporated organisation (CIO) or a Scottish charitable incorporated organisation (SCIO).
- Paragraph 48 dealing with charity tax and trading. We agree that the consequences of non-compliance with tax law is an issue which should be highlighted in the practice note. However, we believe that different examples may better illustrate the risk. The example of an incorrect VAT accrual does not illustrate the severity of the potential consequences of a VAT error by a charity.

A charity which incorrectly assumes a VAT relief, or other tax relief, when none exist could inadvertently create a significant liability. Also, doubtful gift aid claims or expenditure considered non-charitable under the Tax Acts are good examples. Perhaps the second example in the practice note is a reference to non-charitable expenditure but it could also be interpreted as an example of not meeting the public benefit test (an issue which would sit primarily with a charity regulator).

- Paragraph 56. Deeds of covenant are less common than gift aid, so it may appropriate to give less emphasise to covenanting, although we recognise that the new guidance on corporate gift aid may result in an increase in the use of deeds of covenant.

### **ISA (UK) 260: Communication with those charged with governance**

- Paragraph 68 deals with the adequacy of the communication process. It refers to trustees as usually being unpaid and this appears to be mentioned in a way that suggests that this could impact on the adequacy of communication but this is not entirely clear from the wording of the paragraph. We recommend that this is clarified.

### **ISA (UK) 315: Identifying and assessing the risks of material misstatement through understanding the entity and its environment**

- Paragraphs 92 to 95 on dealing with risks arising from IT. While this section does not need to reference all current issues in relation to IT risks, we feel that the wording here tends to underplay the significance for auditors and the problems that result from trying to identify the risks around IT. However, we believe that some areas of risk which are not mentioned would be worth referencing: disaster recovery arrangements; cyber-crime; due diligence on third party providers; and the implementation of the General Data Protection Regulation.

- Footnote 34 on page 19. A reference to arrangements in Northern Ireland for trustees to report incidents at their charity to the CCNI is required.

### **ISA (UK) 320: Materiality in planning and performing an audit**

- Paragraph 100 refers to the trustees being users of the accounts but in the context of an audit they are the accounts preparers: the equivalent in a company to the trustees would be the directors. Paragraph 2, footnote 2 of ISA (UK) 320 indicates that for profit orientated entities, meeting the information needs of investors should also meet the information needs of other users. Therefore, we recommend that the reference to trustees in this paragraph is reconsidered.
- Paragraph 100. This paragraph also highlights that for a charity funded by grants the information needs of grant providers may be considered but it also goes on to refer to the needs of the grant provider, singular. However, the third bullet point of paragraph 2 of ISA (UK) 320 states that:

“Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.”

Therefore, it would not be appropriate to consider the needs of a single grant provider when setting materiality and the drafting of this paragraph may give the impression that an auditor may take this approach. We recommend the wording is revised to more closely reflect paragraph 2 of ISA UK (320).

### **ISA (UK) 510: Initial audit engagements – opening balances**

- Paragraph 139. While we would normally expect the predecessor auditors of non-company charities to give successor auditors access to working papers, we would welcome an amendment to the different bodies of UK charity law to make this a legal requirement. We are making this suggestion, as we are aware of examples where the predecessor auditor has not given access, although we appreciate a change in the law is not within the power of the FRC.

### **ISA (UK) 550: Related parties**

- We would welcome some additional guidance for auditors on trustee remuneration and transactions with trustees in this section, including information and references to the law on the remuneration of trustees in the three charity law jurisdictions. Recent press reports have highlighted examples of trustees and advisers not always being clear on what the rules are around trustee remuneration. We are also aware of examples of transactions between a charity and entities connected to charity trustees which have not been identified as related by the charity.

### **ISA (UK) 570: Going Concern**

- Paragraph 156 on the going concern basis of accounting. There is a reference to the ‘foreseeable future’ which is not a term used in relation to going concern in FRS 102, the Charities SORP (FRS 102) or ISA (UK) 570. We recommend that the wording is revised to focus on the precise requirements of the accounting framework for consistency.

We believe that charity accounts prepared and audited on an ‘other than going concern basis’ will be very rare and in all likelihood, where going concern is an issue, it will be the adequacy of the trustees’ disclosures about material uncertainties which will be the focus of the auditor’s work.

### **ISA (UK) 700: Forming an opinion and reporting on financial statements**

- Paragraph 200. We recommend that this paragraph should refer to ‘governing documents’, not just ‘trust deeds’.
- Paragraphs 201 and 202. The comments applying to charitable companies should also refer to Northern Ireland.

### **ISA (UK) 720: The auditor's responsibilities relating to other information**

- Paragraph 214. This paragraph highlights the challenge of using terminology which distinguishes between the trustees' annual report and accounts and the document which contains the trustees' annual report and accounts and additional surround information, which may be described as the 'annual report. This aspect is handled well, although we recommend that a hierarchy is introduced to the list of bullets to highlight the items which are elements of the trustees' annual report rather than separate items. It may also be appropriate to use terminology which more closely aligns with that of the SORP (for example, 'financial review' rather than 'operating and financial review').
- Paragraph 214. For charities in England and Wales, we recommend adding an additional bullet to the list of items forming part of the trustees' annual report: an 'explanation of activities undertaken for public benefit'. Such a section could include commentary on financial matters such as levels of fees or charges. For example, if the trustees are seeking to demonstrate that these are not a barrier to accessing the charity's services, the auditor needs to review this commentary for consistency with the accounts.

### **Appendix 2: Charity accounting and audit requirements in the United Kingdom**

- Paragraph 2. We recommend that 'may' is inserted into the final sentence to state that "exempt [charities]... 'may' fall to be regulated by an alternative principal regulator". This reflects that the ending of the exempt status for some charities is pending.
- Paragraph 4. We recommend the paragraph is updated to mention that all CIOs are registered (i.e. there is no £5,000 lower limit).

#### **Question 3**

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.

#### **Response**

There is no extant guidance which has been deleted that we believe should be retained.

#### **Question 4**

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?

#### **Response**

We deal with any additional material we would like included in our response to question 2.