CHARITY COMMISSION
FOR ENGLAND AND WALES

Accounts monitoring review: concerns highlighted by auditors in their audit reports

Summary

In 2016, 97 charities filed accounts with a modified audit opinion, meaning that their accounts are, or may be, materially misstated. Approximately half of these charities had gaps in the evidence that supported their accounts, mostly because of deficiencies in their accounting records. The other charities had not followed charity accounting requirements, either by valuing their properties or investments incorrectly or by not including pension liabilities in their accounts.

Why are we reviewing auditors' reports?

Audit reports are a useful way of identifying larger charities that may have significant failings in their accounting records or in their compliance with the Statement of Recommended Practice (SORP). Auditors issue a report at the conclusion of their work, stating whether the charity's accounts give a true and fair view of the state of its affairs at the balance sheet date and of its income and expenditure for that year. If the auditor concludes that the accounts are, or may be, materially misstated, then he or she is required to issue what is termed a modified audit opinion.

All charities with an income over £1 million, or with an income over £250,000 and with gross assets over £3.26 million, require an audit of their accounts. Smaller charities may opt for an independent examination of their accounts instead.

How did we identify auditors' reports with a modified opinion?

We used a text search to identify all the sets of accounts submitted to us in 2016 that contained one of the headings that auditors are required to use when issuing a modified audit opinion: 'qualified opinion', 'adverse opinion' and 'disclaimer of opinion'. Disclaimers of opinion and adverse opinions are the most serious forms of modified opinion in terms of the impact on the accounts of the concerns identified by the auditor.

During 2016, 97 charities submitted at least one set of accounts that contained a modified audit opinion. Ten of these charities submitted two years' sets of accounts during 2016 that contained a modified audit opinion. 86 of the most recent sets of accounts included a qualified opinion, nine had disclaimers of opinion and two auditors gave adverse opinions. The total income reported in the 97 most recent sets of accounts was £195 million.

What did we find?

We reviewed the most recent sets of accounts submitted by each of the 97 charities to assess the nature and significance of the concerns that had led the auditor to issue a modified audit opinion.

The two charities that received an adverse audit opinion had prepared their accounts on the ‘going concern’ basis of accounting, but their auditor had concluded that the charity was not a going concern. The main reasons why the other 95 charities received a modified audit opinion could be summarised into one of two groups:

Lack of evidence to support the figures in the accounts (50 charities)

This group included the nine charities on which the auditor issued a disclaimer of opinion. In the majority of instances, the lack of evidence was due to deficiencies in the charity’s accounting records. The reported lack of evidence affected the following areas of their accounts:

1. The previous year’s closing balances (13 charities)

The previous year’s closing balances form the current year’s opening balances and therefore have an impact on the accuracy of this year’s accounts. For 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. The auditors of another four charities had concerns over the reliability of the previous year’s closing balances. The remaining charity’s subsidiary had not carried out a stock count.

2. This year’s closing balances (16 charities)

Eight of these charities had material amounts of stock and their auditors did not attend the year-end stock count. This was either because the charity did not inform them that stock was material or because the count had taken place before their appointment as auditor. Six other charities had been unable to provide adequate evidence that they owned the properties or investments that they had included in their accounts. The auditors of the final two charities reported uncertainties over the amount of creditors due or the recoverability of a loan that the charity had made.

3. This year’s income and/or expenditure (15 charities)

Seven of these charities did not provide sufficient evidence to support the validity of both the charity’s income and expenditure. Their trustees appear not to have had proper oversight of some of the charity’s activities, including those administered on its behalf by a third party. For six charities, the auditor was unable to confirm whether all of the income that was due to the charity had been included in the charity’s accounting records. This was because the charity had not kept records or relied on voluntary donations. The remaining two charities could not provide evidence to support the validity of their expenditure.

4. This year’s disclosures (three charities)

The trustees of two of these charities had not provided complete information to their auditors on their related parties. The trustees of the other charity did not provide information to support their going concern assessment.

5. This year’s accounts as a whole (three charities)

The deficiencies in the records of these charities undermined the whole of their accounts. All of these charities received a disclaimer of opinion.

Trustees have a legal responsibility to ensure that their charity keeps adequate accounting records. Poor or incomplete accounting records indicates inadequate oversight of the charity’s activities and increases the risk of fraud or loss.

Material non-compliance with the SORP (45 charities)

Five of these charities had not prepared group accounts, although required to do so because they had material subsidiaries. All of the other 40 reported examples of SORP non-compliance were concerned with the valuation of assets and liabilities and all but two of them fell into one of two groups:

1. Property and investment assets incorrectly valued (27 charities)

The SORP offers charities some flexibility in setting their accounting policies for calculating the capital value of properties held for charity use, but once they have established their accounting policies they must follow them. Charities must show their investment assets, including properties, at market value. Twenty charities had assigned values to their land, buildings and/or investments that were out of date or calculated on an incorrect basis, such as at cost instead of market value. Four charities had failed to depreciate assets with a finite life and the remaining three charities had not included some or all of their land and buildings in their accounts.

2. Pension scheme liabilities not included (11 charities)

These charities are all members of defined benefit pension schemes and could identify their share of the scheme’s assets and liabilities. However, they had not obtained the necessary information from the scheme actuary on the estimated liability and associated disclosures. These charities’ accounts therefore provide an incomplete picture of their liabilities.

3. Other assets or liabilities incorrectly valued (two charities)

These charities had incorrectly valued either their stock or grant commitments.

The notes to several of these charities’ accounts explained or justified why they did not comply with the SORP. Whilst some trustees stated that they had been unable to obtain the necessary information, most had chosen not to comply. The reason was usually that the trustees did not feel that the cost of obtaining the required professional valuations of property or of pension liabilities and disclosures was a good use of charitable funds. The unspecified cost of obtaining the necessary information is not an acceptable reason for deciding not to comply with the SORP’s requirements. Depending on the circumstances, the accounts may mislead potential donors about the charity's financial circumstances by incorrectly valuing the charity's assets or not including its pension liabilities.

What action did we take?

With individual charities

We considered the issues highlighted in each audit report and any relevant disclosures in the trustees' annual report and accounts to assess whether any regulatory action was required. We also checked our records to see if we had recent engagement with the charities identified in this review. We took into account the audit opinions given on more recent accounts, where submitted. Our regulatory response fell into one of three categories:

1. No action required (51 charities)

We took this approach where:

- we have already engaged with the trustees over the concerns reported by their auditor (16 charities)
- the issues reported by the auditor were not of significant regulatory concern, because they related to opening balances or stock count attendance and there were no indications of other concerns (14 charities)
- the trustees explained in the annual report that they were dealing with the issues reported by their auditor (5 charities)
- a more recent set of accounts was available on which to base our assessment (16 charities). Eleven of these more recent sets of accounts did not contain a modified audit opinion

2. Guidance required (36 charities)

We took this approach where we judged that the trustees should be able to address their auditor's concerns. Thirty one charities were amongst those where the modified opinion was because of SORP non-compliance. In these instances, we drew the trustees' attention to the content of the modified audit opinion and stated that we expected them to take action to comply with the SORP in their following year's accounts. Links to guidance were included where appropriate.

3. Engagement with the charity (10 charities)

We took this approach where the auditor's concerns highlighted serious failings of which we were not previously aware and there was no indication that the trustees were taking action to address them. In nine cases, the modified opinion concerned deficiencies in the charity's accounting records.

With the audit profession

In April 2017, the UK charity regulators issued updated guidance on reporting matters of material significance. This introduced a requirement for auditors to report to the appropriate regulator as soon as they issue a modified audit opinion and came into force on 1 May 2017.

Within the Commission

We are continuing our programme of reviewing sets of accounts submitted to us that contain a modified audit opinion. This means that if the following year's accounts submitted by the charities included in this review also receive a modified audit opinion, we will follow them up. In addition, we highlight the submission of a modified audit opinion on the charity's public information on our website.

What are the lessons for other charities?

If a charity's auditor issues a modified audit opinion on the charity's accounts, this may damage supporters' and funders' confidence in the trustees' governance of that charity. To minimise the risk of a modified audit opinion, trustees need to check that their charity has sound financial systems and accounting records in place, take SORP compliance seriously and work with their auditors to provide the information that they will need for their audit. Where appropriate, the trustees' annual report should explain the circumstances behind a modified audit opinion and provide assurance that the trustees are taking action in response to the concerns reported by their auditor.

We have produced a range of guidance to help trustees. Internal financial controls for charities (CC8) and Charity reporting and accounting: the essentials November 2016 (CC15d) are good starting points for the issues identified in this review.

The current version of the SORP can be found on the dedicated SORP website, which also includes help-sheets and worked examples.

About our accounts monitoring reports

Charities' accounts are publicly available on our online search tool Find charities

In addition to reviewing sets of accounts with modified audit opinions, we also monitor a sample of accounts to check for accounts quality and the reporting of public benefit. The outcome of our accounts monitoring activity is a series of reports on our findings to help trustees manage the risks that their charity faces, improve reporting standards and enhance the accountability of charities to their donors, beneficiaries and the public.