

## Accounts monitoring review Reporting of matters of material significance by auditors

## Summary

Auditors have an important role and their reports of matters of material significance inform our regulation of the charity sector and enable us to engage more promptly with charities in difficulty. In the six months to 31 October 2017, the auditors of 114 charities gave audit opinions containing information that they were required to report to the Commission as a matter of material significance. Only 28 reports were received. This low level of reporting by auditors is of significant concern, particularly in the context of the findings of the Public Administration and Constitutional Affairs Committee into the collapse of Kids Company. We are therefore working with the accountancy profession to improve auditors' awareness of and compliance with their reporting duties.

## Why are we reviewing auditors' reporting?

Auditors of UK charities have a long-standing duty to report any matters of material significance that they identify in the course of their work to their respective charity regulator, as soon as they become aware of it. With effect from 1 May 2017, the list of reportable matters includes where an auditor intends to give a modified audit opinion and/ or an audit opinion that includes paragraphs about an emphasis of matter or a material uncertainty regarding going concern. <u>Matters of Material Significance reportable to UK charity regulators</u>.

In November 2017, the Financial Reporting Council issued a revised version of Practice Note 11: The audit of charities in the United Kingdom. This includes a section on the auditor's responsibility to report matters of material significance to charity regulators.

The reports of matters of material significance from auditors provide valuable information to the UK regulators. This informs our regulation of the charity sector and enables us to engage more promptly with charities in difficulty. Our reports <u>Concerns highlighted by auditors in their audit</u> reports and <u>Charities with audit reports identifying that they may be in financial difficulty</u> provide details of the matters highlighted by auditors in modified audit opinions and emphasis of matter paragraphs and examples of where we have engaged with charities as a result.

We therefore want to ensure that auditors of charities registered in England and Wales are aware of this extension to their reporting duties. We have chosen to focus on the period from 1 May to 31 October 2017, the first six months since the updated list of reportable matters came into force.

Independent examiners also have a duty to report matters of material significance to the UK regulators, but they are not included in this review. We published updated guidance for independent examiners in September 2017 and this became mandatory from 1 December 2017.

# How did we identify auditors' reports with a modified opinion or other reporting paragraph?

We used a text search to identify all the charities that had submitted sets of accounts to us in the period 1 May - 11 December 2017 containing one of the headings which auditors are required to use when issuing a modified audit opinion or one of the other reporting paragraphs. We checked each audit report to identify those where the date of the opinion fell in the period 1 May - 31 October 2017. We then compared the list of charities with our records of the reports from auditors submitted to us in the period 1 May - 11 December 2017.

We continued our review to 11 December 2017 so that we could allow at least six weeks from the date of the audit opinion for the charity to file its accounts and for the auditor to submit his or her report to us. However, delays in the filing of accounts by charities and in reporting by auditors mean that our review provides a snapshot of the reports that should have been submitted, not a complete picture.

## What did we find?

### Auditors' compliance with their duty to send a report to the regulator

### The completeness of auditors' reporting

We identified 114 charities where the auditor had given a modified opinion and/ or included one of the other reporting paragraphs in the six months ended 31 October 2017. We had received reports from the auditors of 28 of these 114 charities by 11 December 2017. An analysis is given below.

Type of opinion and reporting paragraph/ number of charities	Number of charities where report required	Number of charities where report received
Modified opinion only	28	3
Modified opinion and emphasis of matter paragraph	6	3
Emphasis of matter paragraph only	75	20
Material uncertainty related to going concern paragraph only	5	2
Total	114	28

The Commission is concerned by this initial low level of reporting, particularly in the context of the findings of the Public Administration and Constitutional Affairs Committee into the collapse of Kids Company. It also raises the question of whether the other eight reportable matters listed in the guidance are also under-reported.

### The speed of auditors' reporting

Auditors must report to us as soon as they intend to offer a modified audit opinion or one of the other reporting paragraphs. The auditors of 6 of the 28 charities in respect of which a report was received reported to us promptly, measured as being no later than one day after the audit report was signed. An analysis is given below.

Time after audit opinion given	Number of charities where report received
Before opinion given	2
Date of opinion or following day	4
Within 1 week	6
Within 2 weeks	5
Within 1 month	3
Within 2 months	5
More than 2 months	3
Total	28

## Trustees' compliance with their duty to file their charity's accounts with the regulator

#### The speed of trustees' filing

It is the trustees' responsibility to file their charity's accounts. Charities have 10 months from their financial year end to do so, although we encourage them to file as soon as possible. 16 of the 114 charities filed their audited accounts promptly, again measured as being no later than one day after the audit report was signed. An analysis is given below.

Time after audit opinion given	Number of charities where accounts received
Date of opinion or following day	16
Within 1 week	27
Within 2 weeks	16
Within 1 month	18
Within 2 months	26
More than 2 months	11
Total	114

Seven charities waited more than 100 days to file their accounts. Therefore, prompt reporting to us by auditors could mean that we receive information about potential regulatory concerns at a charity significantly earlier than waiting until the charity files its accounts.

#### The filing of undated audit reports

In addition to the 114 charities included in this review, our analysis identified a further 17 charities that submitted sets of accounts in the period 1 May - 11 December 2017 with a reportable opinion, but the audit report filed with us did not contain the date of the opinion. However, we do not know whether the version of the audit report that each charity submitted was the final version provided to the trustees by the auditor.

The auditors of 3 of these charities did report to us. As we have seen, there can be a significant delay in filing the accounts after the audit report was signed. This means that we cannot identify which of the auditors of the other 14 charities were required to report to us.

### What action we took

### Updating the guidance on reporting matters of material significance

Our initial work on this review identified that some auditors were including an emphasis of matter paragraph to highlight that the accounting regulations in England and Wales have not been updated to replace references to the superseded 2005 SORP. In these circumstances, there is nothing the charity, the auditor or the regulator can do to put things right. To reduce the reporting burden on auditors, in November 2017 the UK regulators updated the guidance on reporting matters of material significance to exclude references to regulations being out of date from the list of reportable matters.

Our analysis therefore does not include an additional 38 charities we identified where the audit report contained an emphasis of matter paragraph concerning the out of date regulations, although this was a reportable matter until the amendment to the published guidance made in November 2017.

### Working with the accountancy profession

For the 114 charities identified in this review, we have used the online member search tools of the ICAEW and the ACCA to find out which accountancy body regulates their auditor. ICAEW regulated firms gave the majority of reportable opinions in the period. An analysis is given below.

Type of opinion and reporting paragraph/ number of charities	Number of charities where report required	Number of charities where report received
ICAEW	107	28
ACCA	6	0
Other	1	0
Total	114	28

To put the extent of non-reporting in a wider context, we also analysed the reporting by ICAEW auditors between the audits carried out by the 10 firms that earn the highest annual fee income from auditing charities, according to the Charity Financials analysis, and those carried out by other firms or practitioners. The reporting performance of the 10 largest ICAEW charity audit firms was better than smaller firms and practitioners. However, the smaller firms and practitioners gave the vast majority of the reportable opinions. An analysis is given below.

Type of opinion and reporting paragraph/ number of charities	Number of charities where report required	Number of charities where report received
Largest charity audit firms	20	8
Other firms or practitioners	87	20
Total	107	28

We are keen to work with the accountancy profession to raise standards of accountability and transparency within the charity sector. Auditor reporting on all matters of material significance has a key part to play in this. Therefore, we are writing to all of the firms or practitioners that did not file a report, reminding them of their responsibility to report a matter of material significance to us and asking them to explain why they have not done so.

We are also writing to all the firms or practitioners named in the undated audit reports, asking them to confirm whether they did audit the accounts and, if so, whether their report contained a modified opinion or other reporting paragraph. We have reminded them of their responsibility to report a matter of material significance to us, where required. We have also asked them to advise the charity's trustees to resubmit their accounts with the final, dated, version of their audit report.

In advance of publication, we have shared this high-level analysis with the ICAEW and the ACCA and invited them to comment on our findings. ACCA have provided a statement to this report. The Commission is also working with the ICAEW and the ACCA on educational initiatives to help them raise awareness amongst their members of the auditor's reporting duties.

Given that we are working collectively to raise awareness of this statutory duty, we are developing a formal framework with the ICAEW and the ACCA to share information on trends in reporting, including those of poor practice by their members, under a memorandum of understanding. This may include the failure to report a matter of material significance to the regulator.

## What are the lessons for other charities?

Trustees need to be aware of the list of matters of material significance and of the duty placed upon an auditor or independent examiner to report these matters to the regulator.

Trustees have a parallel duty to report serious incidents to the regulator. Where a charity's auditor or independent examiner decides to report a matter of material significance, the trustees should consider whether they also have a duty to report a serious incident. <u>How to report a serious incident in your charity</u>.

We encourage trustees to submit their audited or independently examined sets of accounts as soon as they are available, so that their public information is up to date. When preparing their submissions, we recommend that trustees check that they have included the final version of the auditor's or independent examiner's report, stating the date on which the opinion was given.

## Annex: ACCA statement on the Charity Commission report

We welcome this report and for the opportunity to include this short statement.

This is an important accounting monitoring review of auditors' responsibilities from the Charity Commission, with findings on which ACCA will be taking action.

We believe this action is necessary because of our Royal Charter and our work to protect the public interest, promote responsible and ethical business and support economic performance. It's vital that the charity sector delivers timely and trustworthy information to the Charity Commission, as accountancy professionals working in the charity sector act in the public interest.

The accountancy profession is often the first line of defence for important financial and regulatory issues such as alerting authorities to fraud or money laundering. There is a responsibility on the profession to uphold the highest of standards, regardless of the sector.

For example, for all charity audits or independent examinations conducted and /or reported after 1 May 2017, there is a statutory responsibility to report matters of material significance to the regulator. It is clear from this report that this has not been happening.

As a result of this review and its findings, we are working closely with the Commission and our members to ensure the value of audit and all reporting for the charity sector remains a top priority. It is important for anyone involved in the charity sector, especially trustees, auditors, independent examiners, internal auditors and professional bodies, to take appropriate action.