

**ICAEW Charity Webinar**

**20 July 2021**

# **An update on charity auditing – looking back and looking forward**

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# Webinar Introduction



- Looking back
  - Revised ISAs
    - ISA 540
    - ISA 570 (Revised)
    - ISA 700
  - How have charities and auditors responded – experiences and practical lessons and good practices
- Looking forward
  - BEIS Consultation and proposed audit reforms
  - Other auditing changes due – ISAs and other
  - The current state of charity auditing

# Looking back –

**Our experiences of  
applying the revised  
ISAs 540,570 & 700**

**Stuart McKay**

**September 2021**





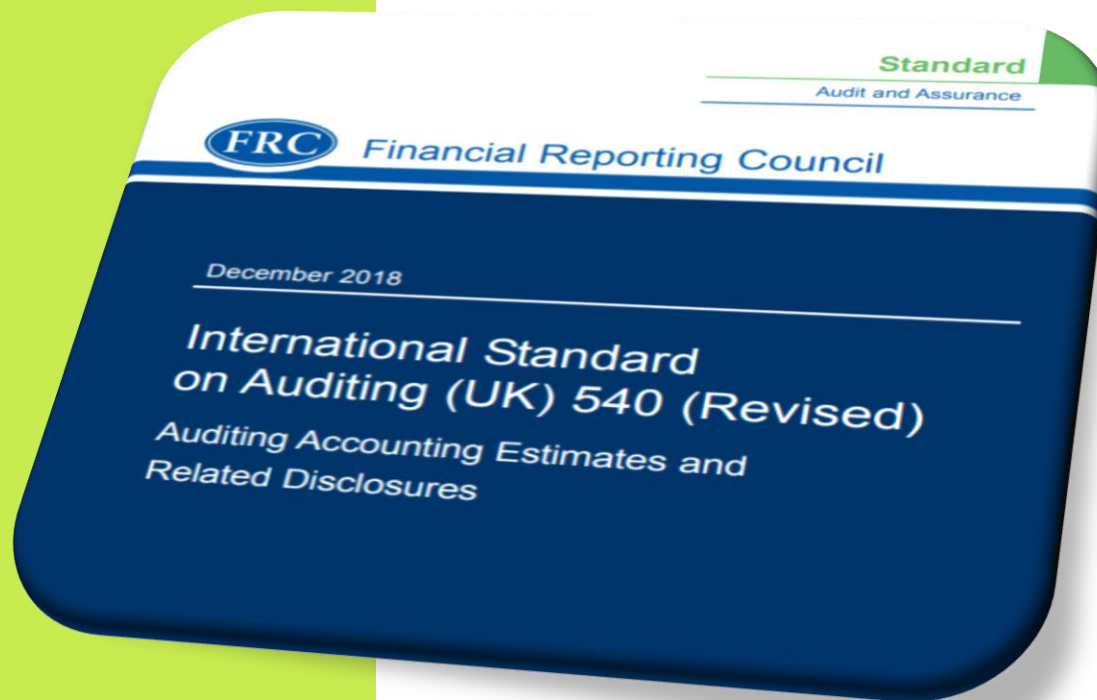
# Accounting Estimates – ISA 540 Practicalities Stuart McKay – MHA MacIntyre Hudson

# ISA 540 (revised) Accounting estimates



## Effective date

- p/c on after 15/12/2019
- Early adoption allowed





# Examples of accounting estimates

- Bad debt provisions
- Depreciation
- Inventory valuation
- Valuation of investments
- Measurement of legacy income
- Treatment of leases
- Outcomes of litigation
- Revenue recognition –  
measurement of Performance  
related grants
- Pension assumptions
- Translation of foreign currency  
items.



**Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

**A change in accounting estimate** is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability.

# Estimates vs Policies



# ISA 540: Accounting Estimates

## Requirements of the revised ISA

- Risk assessment procedures
- Separate Inherent Risk & Control Risk assessments at assertion level
- Responses to assessed risks
- Stand-back evaluation and reasonableness of disclosures
- Communications with TCWG
- Documentation, scepticism and scalability





# ISA 540: Accounting Estimates

## Document & identify @ planning:

- Transactions, events and conditions that may give rise to estimates
- Requirements of accounting frameworks that give rise to estimates (PRG for e.g.)
- How estimates apply in the context of the entity and its environment (Inherent Risks)
- The auditors expectation of estimates.



# ISA 540: Accounting Estimates

## Assess @ planning if:

### Action Points:

- Planning agenda
- Audit Plan (ISA260) enhancements

- TCWG have the skills or knowledge to understand the characteristics of a particular method or model to make accounting estimates.
- TCWG know whether their estimates are within the parameters of the accounting framework
- Have TCWG evaluated and challenged the estimates made by mgt
- What oversight do TCWG have over the estimates that mgt make.



# ISA 540: Accounting Estimates

## Test outcomes

- Review the outcome of estimates used in the prior period.
- Use PBSE to provide supporting evidence
- Review consistency and reasonability
- Review/challenge estimate in light of the parameters of the accounting framework
- Develop parameters for when an estimate could be materially misstated
- Identify possibility for mgt bias
- Test mathematical accuracy
- If experts have been used assess competency etc



# ISA 540: Accounting Estimates

## Test outcomes II

### Action Points:

- Record misstatements in accounting estimates
- Include in Audit Findings (ISA260) a separate section on estimates?
- Make recommendations to TCWG?

- Review underlying data integrity
- Develop an ‘auditors point estimate’ or range
- Apply professional scepticism
- Step back – evaluate whether any of management’s judgments or decisions either individually or as a whole, are indicators of possible mgt bias.



**Going concern –  
ISA 570  
Practicalities  
Stuart McKay – MHA MacIntyre Hudson**



# Auditing Standards changes p/e 31/12/20

- **Going concern – ISA 570 (Revised 2019)**
  - Requirement to document robust challenge of management's assessment of going concern including possible bias
  - Requirement to obtain evidence regarding, and conclude on, whether a material uncertainty relating to going concern exists
  - Introduction of a 'stand back' assessment – A final consideration of all evidence (corroborative and contradictory) before drawing the audit conclusion
  - Changes to standard audit report wording – auditors now need to provide a positive conclusion on a) going concern basis being appropriateness & b) whether material uncertainties exist
- **Reminder: Whistleblowing (Matters of material significance)**
  - Charity Commission reporting



# Going Concern - tips

## Be proportionate

- Don't be afraid to conclude there is a low GC risk
- Make sure you explain why

## Do the basics!

- Verify starting balances
- Linkage to non-financial drivers tested
- Test arithmetic

## WATCH OUT FOR

- Furlough ends in September 2021
- Will COVID-19 restrictions return in Winter –trading at below capacity can cause losses.
- UK recession still looms
- Bounce back loans need repaying
- Loan covenants will be watched carefully.
- Skills shortage in UK



# Going Concern - tips

## Robust challenge

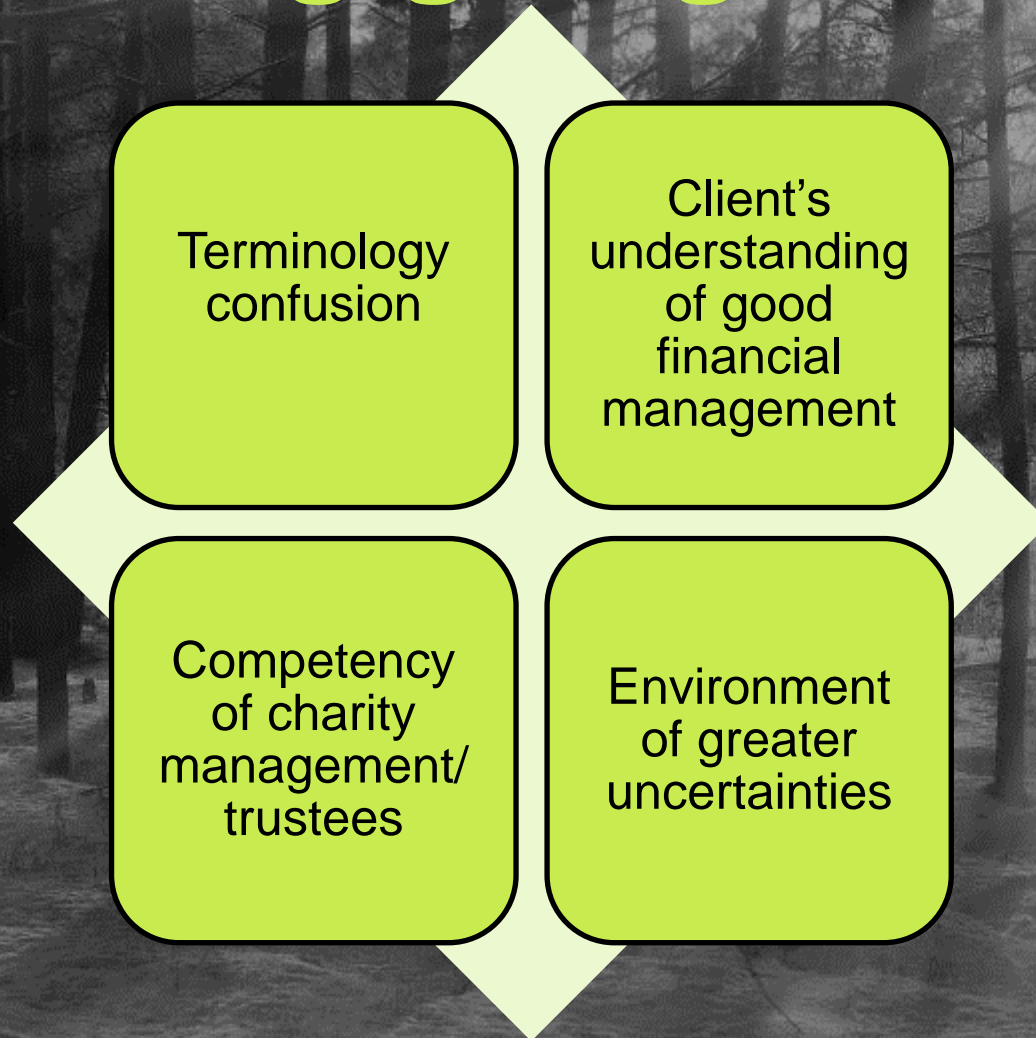
- Look at external market data and trends
- Fundraising income and donations assumptions
- Review return on investment assumptions
- Review confirmed vs unconfirmed income streams
- Availability of resource may lead to project delays
- Timing of payments

## Identifying key uncertainties

- Scenario planning
- Stress testing
- Contingency planning
- Availability of reserves – liquidity of reserves

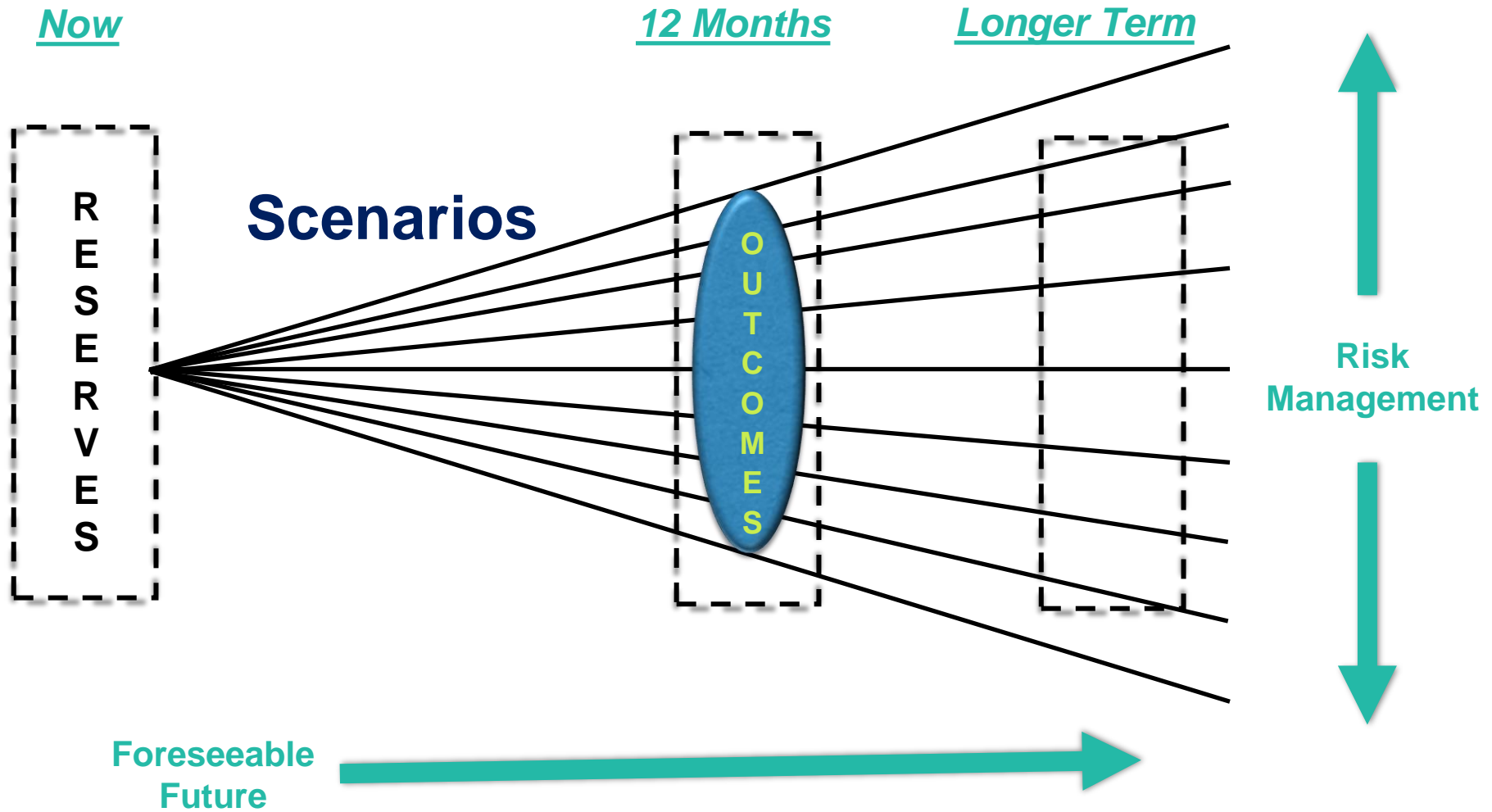


# Practical issues in addressing going concern



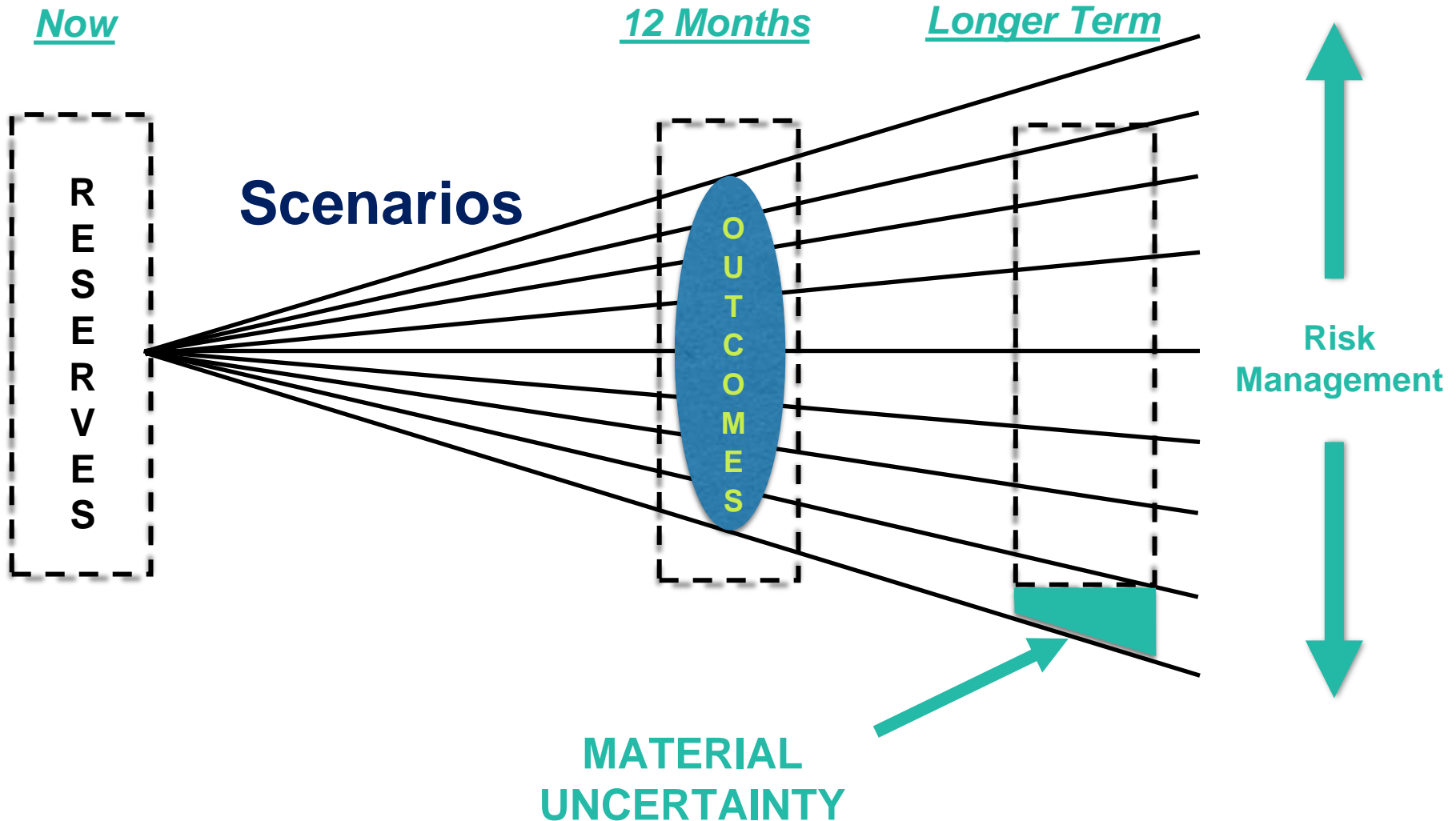


# Integrated scenario planning





# Integrated scenario planning



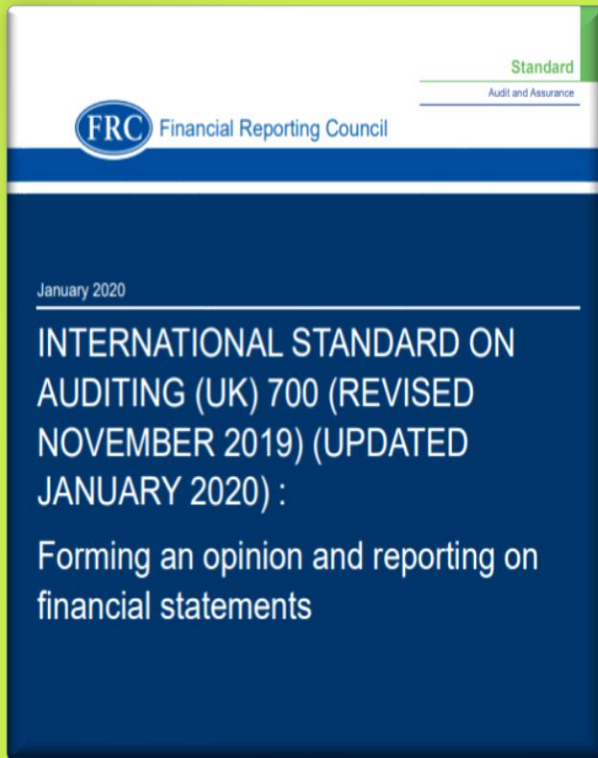


1. Future has increased uncertainties for many charities
2. Greater demands on auditors and charities on going concern reporting
3. A proactive approach is essential
4. Consider greater transparency and accountability when reporting on going concern

# Conclusions



# **Audit Reports– ISA700 Practicalities Stuart McKay– MHA MacIntyre Hudson**



## Extends PIE requirement to all audits

- Explanation of extent to which audit was capable of detecting irregularities, including fraud

### 1. Auditors' responsibilities

- Tailored – not boiler-plate
- Matters of significance
- Clear and concise

### 2. Going Concern

- Appropriate use of GC assumption
- We have not identified material uncertainties

## Changes

### Effective date

- p/c on after 15/12/2019

# GOING CONCERN

## BEFORE



### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Trustees' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Trustees have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the charitable company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

## AFTER

*In auditing the financial statements, we have concluded that the Trustees' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.*

*Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.*

*Our responsibilities and the responsibilities of the Trustees with respect to going concern are described in the relevant sections of this report.*

# Auditors Responsibilities



## ***Auditor's responsibilities for the audit of the financial statements***

*Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.*

*Irregularities, including fraud, are instances of non compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:*  
***[Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud.]***

*A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our Auditor's Report.*



# Auditors Responsibilities



Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

## Irregularities?

Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations

## Need to consider how we obtained understanding of:

- Legal / regulatory framework
- Entity's policies / procedures on compliance with laws & regs
- Entity's policies / procedures on fraud
- RI's assessment of whether engagement team had competence / capabilities to identify non-compliance
- In a regulated entity, entity's current activities and scope of authorisation

## Group audits

How is this address at group and component levels.

# Tips

## Cross referencing the audit report to the audit file



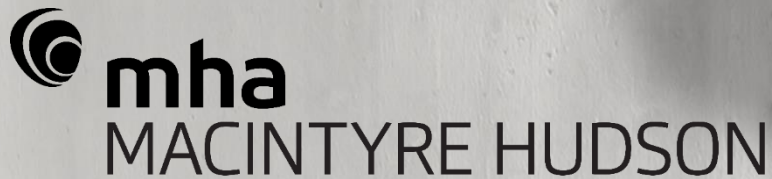
### Areas reported upon:

- Obtaining an understanding of the legal and regulatory frameworks
- How and where fraud might occur in the financial statements and any potential indicators of fraud;
- Consideration of known or suspected instances of non-compliance with laws and regulations and fraud;
- Actual and potential litigation and claims;
- Evaluation of the operating effectiveness of management's controls designed to prevent and detect irregularities;
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular with respect to provisions for claims incurred but not reported

# Charity auditing – looking forward

**Sudhir Singh**

**September 2021**





# Charity auditing: Looking forward

## Topics to cover

- BEIS Consultation and CC response to proposed audit reforms, and wider implications
- Other auditing changes due – ISAs and other
- The current state of charity auditing



# FRC Annual Audit Quality Inspection Results 2020/21

The 2020/21 results show that nearly one third of audits inspected by the FRC still require improvement.

- 29% of audits reviewed required improvement or significant improvement
- Quality across firms was mixed; improvement measures implemented

*Sir Jon Thompson, FRC CEO said:*

*“While these results show some improvement on last year’s results, this improvement is marginal and significant change still needs to happen to meaningfully improve audit quality”*



# Charity Commission Accounts Monitoring Review 2019

*“Our review has highlighted that the trustees of a significant number of charities have appointed auditors or examiners whose work does not meet our external scrutiny benchmark”*

For audits undertaken by ICAEW members in 69 out of 203 accounts examined the external scrutiny reports did not meet the Charity Commission’s minimum criteria

# BEIS consultation

## Restoring trust in audit and corporate governance

Consultation on the government's proposals

March 2021

Closing date: 8 July 2021

CP 382



Proposals affect:

- Directors [Trustees]
- Audit, auditors and audit firms
- Shareholders
- Audit Regulator

Key concern is definition of Public Interest Entities



# BEIS consultation

Key concern is definition of Public Interest Entities to include third sector entities with public benefit purpose

- ❑ Included to avoid “gap in regulation”
- ❑ Examples quoted: Universities, charities and housing associations
- ❑ Could include other “third sector” organisations? Colleges, academies, NDPBs?
- ❑ Definition of “Suitable threshold” – incoming resources exceeding £100m or higher?





# **BEIS consultation – audit considerations**

- Implications for charity auditors and audit firms market?
- Engagement Quality Control Reviews
- “Long form” audit reports
- Subject to FRC Audit Quality Reviews (or their successor)
- Two tier charity auditing
- Cost

## Disproportionate?

# Little appetite for PIEs



CHARITY COMMISSION  
FOR ENGLAND AND WALES



*“....in terms of the charitable sector the Commission’s position is that it does not support extending a framework designed with the interests of shareholders and for-profit commerce in mind to the charity sector where these imperatives simply do not apply.”*



**Expectations  
of charity  
audits and  
auditors .....  
The need to  
restore  
trust?**



**Public accountability versus  
accountability to the public?**



# Some alternative responses?

- Discretionary adoption of PIE approach by audit firms? Use standards expected by Audit Quality Reviews? Expectation of quality improvement for all.
- Trustee attestation of internal controls effectiveness
  - CC Annual Return – already requires confirmation
  - Should charities have a Charity-SOX approach?
- Financial reporting – clarifying trustee responsibilities
  - Going concern – adopting resilience statements
  - Board assurance - Audit and Assurance Policy
- Future of charity financial reporting under revised Charities SORP
  - E.g. Narrative reporting – impact and sustainability
  - Update needed for PN11?



# Auditing Standards changes - reminders

- FRC Bulletin (Published August 2021) – Illustrative auditor’s reports (P/C after 1-2-20)
- ISA 240 (Revised May 2021) – Risk of material misstatement due to fraud (P/C after 15-12-21)
- ISA 315 (Revised July 2020) – Risk assessment changes – general not charity specific (P/C after 15-12-21)
- IAASB draft auditing standard (Published July 2021) – Less Complex Entity (LCE) audits (Consultation ends 31-1-22)



# The future for charity auditing?





# Conclusions

1. Statutory audit reform changes affecting charities – appears remote
2. Wider expectations of audit quality improvement – charity sector will inevitably be affected
3. Specialist expectations of charity auditors likely to increase



**Questions?**