



CHARITY AUDIT AND INDEPENDENT EXAMINATION

ICAEW welcomes the opportunity to comment on the consultation paper *Charity Audit and Independent Examination* published by the Cabinet Office on 9 December 2014, a copy of which is available from this [link](#).

This ICAEW response of 27 January 2015 reflects consultation with its Business Law Committee, the Charity Technical Sub-Committee of that Committee and its Audit and Assurance Faculty.

The Business Law Committee and its Sub-Committee include representatives from public practice and the charity and business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

The Audit and Assurance Faculty is recognised internationally as a leading authority and source of expertise on audit and assurance issues and is responsible for audit and assurance submissions on behalf of ICAEW. The Faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 142,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

1. Effective financial management of charities is crucial to the well-being of the sector and independent scrutiny of accounts, whether by audit or independent examination is an important part of that. The consultation does not propose increasing the £250,000 threshold at which independent examination by a professionally qualified independent examiner is required and we agree with that.
2. There is unlikely to be a 'right' level to set the thresholds to catch all charities that would benefit from the rigours of the audit and exclude all those that would not. To some extent, the levels are arbitrary based on assessment of the risks and benefits in ways that will be difficult to quantify. This is reflected in our discussions with members where there were diverging views, with some supporting the proposed increase in the income threshold and others seeing no reason to change it. We do not, therefore, express a view on this particular issue.
3. However, the independent examination is not as robust as an audit. It is designed also for reports to may be made by non-professionals for relatively small charities (over the £25,000 income threshold). While the standards applied by professionally qualified independent examiners might be expected to result in a greater level of assurance than otherwise, the inherent nature of the process is limited when compared to an audit (as noted by the Charity Commission in its guidance and associated directions, CC32). In particular, verification is required only in limited circumstances. If the thresholds are to be increased as proposed, more relatively large and potentially complex charities may adopt the independent examination and we believe that its fitness to provide assurance for the full range of charities should be reviewed and any specific gaps or weaknesses addressed to mitigate the risks.
4. The anticipated cost saving for charities from the proposals may have been overestimated. For instance, it is unclear whether sufficient allowance has been made for charities that might continue to use audit because they are required to do so (eg in their trust deeds) or choose to do so. Charities with income between £500,000 and £1,000,000 may be more complex than smaller charities which could lead to additional work being required.
5. If the thresholds are to be changed, then the opportunity should be taken to simplify the regime as a whole. We believe that the asset test should be removed completely (and if there are concerns about this, that the independent examination should be adapted to address those concerns). The key priority should be to ensure that scrutiny of accounts of all charities with material assets is appropriate, whether through audit or independent examination, irrespective of whether income is £250,000 or less, £500,000 or £1,000,000.
6. Government should adopt a co-ordinated long term approach to reforms of this nature with a view to producing a regime which is clear and as simple as possible to meet the underlying objectives. The Charity Commission has published two new SORPs, to be applied for periods commencing 1 January 2015. This consultation indicates that resultant amendments will be effective from 6 April 2015, although it is unclear whether this will be for periods commencing or ending on that date or otherwise. The proposals on asset thresholds are based on thresholds for companies which themselves may change. The net effect is that there are a number of moving targets which is unhelpful to the sector.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree that the income threshold at which charities should have to have their accounts audited should be increased from £500,000 to £1 million?

7. Please see our main comments above.

Q2. Do you agree that the aggregate group income threshold at which parent charities should have to have group accounts audited should be increased from £500,000 to £1 million?

8. We agree that the same threshold should apply to parent charities, so if the threshold referred to in Q1 is increased, this threshold should also be increased.

Q3. Do you agree that the income component of the asset threshold should be increased from £250,000 to £500,000?

9. No. We believe that any asset test should be removed and any concerns that might arise as a result should be addressed through other measures.

Q4. Do you think that the asset component of the asset threshold should stay at £3.26 million in line with companies law (Option 1) or increase to £5 million (Option 2)?

10. We think that the asset threshold should be removed. The company law tests as a whole are not the same as those involved here, so there is no compelling reason to have the same asset threshold in this context. If the company law threshold is adopted it would be preferable to make the change at the same time as the revised company law threshold takes effect to minimise the number of changes required.

Q5. Do you envisage any difficulties arising from these proposed changes to the threshold? If so, please provide evidence to support your view.

11. There is a risk that the changes will weaken financial control over larger charities and we recommend that the scope and nature of the independent examination be reviewed with a view to minimising the risks involved.
12. The risks are not readily quantifiable in monetary terms, but the consideration of this issue in the impact assessment appears to be somewhat cursory. The regime for independent scrutiny of accounts of charities needs to be robust to instil confidence in financial reporting by charities and, therefore, trust in the sector. The independent examination is not as robust as a full audit so that, even where conducted by a professional firm, the same level of assurance cannot be expected to result from independent examination.
13. The impact assessment cites a survey suggesting that the public does not perceive large charities to be more trusted than small ones. There can be many explanations for this which have nothing to do with audit. In particular, large charities are more often in the public eye and may need to take controversial decisions.
14. The assessment also says that 'charity fraud will remain unlikely'. While we would not suggest that the proposed changes will necessarily have a material impact on levels of fraud in charities, this assessment of the current position appears to be at odds with the increased funding being provided to the Charity Commission for proactive monitoring and enforcement in the 'highest risk areas like abuse of charities for terrorist and other criminal purposes, such as tax avoidance and fraud'.

Q6. Do you agree with the estimated costs and cost savings outlined in Part IV? It will be helpful if you can provide actual examples of the difference in the costs between the Page 11 two forms of examination.

15. While the work in carrying out an independent examination is likely to be less than that required for an audit of any given charity so that the reforms can be expected to produce some savings for charities in aggregate, as noted in our introductory comments, we believe that the potential costs savings may have been overestimated.

Q7. Do you have any other comments about the proposed change to the threshold? Increasing the preparation threshold for group accounts

16. No.

Q8. Do you agree that the preparation threshold for group accounts should be consequentially increased in line with the audit threshold from £500,000 to £1 million?

- 17.** If the threshold is to be increased for charities generally, increasing the threshold for group accounts would have the merit of consistency and simplicity.

Q9. Is there a recognised professional accountancy membership body that you propose could be added to the list of those whose appropriately qualified members can carry out independent examinations of the accounts of charities with incomes that are more than £250,000?

- 18.** We have no proposals.

Q10. If you have suggested a body to be added to the list of those whose members should be able to act as independent examiners, please provide a detailed explanation of how they meet the criteria outlined in this document.

- 19.** N/A