



Directions for independent examination and related guidance including proposals to extend independent examination to consolidated accounts

ICAEW welcomes the opportunity to comment on the *Directions for independent examination and related guidance including proposals to extend independent examination to consolidated accounts* published by Charity Commission on 3 June 2016, a copy of which is available from this [link](#).

This ICAEW response of 30 September 2016 reflects consultation with the Charity Technical Sub-Committee of the ICAEW Business Law Committee. The Sub-Committee includes representatives from public practice and the charity sector and the Business Law Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

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MAJOR POINTS

1. The Government's decision to increase the audit threshold for charities from £500,000 to £1,000,000 in England and Wales allows a less demanding independent scrutiny of the accounts in this segment of the sector. As a result we agree that it is appropriate for the Charity Commission to seek to deal with the resultant risks by strengthening the independent examination regime for affected charities. This is particularly important as failings in large charities may have a high impact on the sector and public perception of it.
2. However, some aspects of the new regime, in particular in Direction 9, appear to be disproportionate when applied to small charities and we believe that, if the changes are introduced as envisaged, there will be unintended adverse consequences in this segment. We identify the main areas of concern in this respect later in this response.
3. The Government's stated aim in raising the audit threshold was to reduce red tape and costs for affected charities (though the Government's Dec 2014 consultation document stated that there were just 3,140 registered charities in the £500K to £1M income band). While the proposed increased rigour for independent examination may result in some increased costs for those charities, it is still likely in many cases to be less rigorous (or costly) than an audit. However, the new regime is likely to increase the burdens and costs for tens of thousands of small charities and, taken in the round, the proposals appear to be at odds with the Government's original objective in changing the audit threshold.
4. We therefore recommend that the Directions be restructured, so that identified core Directions apply to all independent examinations and that certain additional Directions apply only to large charities and that guidance be tailored accordingly in each case. In particular, guidance applicable to small charities should be designed to be as easy as possible for volunteer independent examiners to understand and apply if it is to be as effective as possible.
5. The question then arises as to how 'small' and 'large' should be defined in this context. We suggest that the £250,000 income threshold at which independent examination is required to be conducted by qualified independent examiners be applied in this context in the interests of simplicity and irrespective of whether or not receipts and payments or accruals accounting applies (because many very small charities are operated as companies where accruals accounting is required).
6. To introduce another threshold would risk introducing further complexity in an area which already seems unnecessarily complicated for charities across the UK. The audit threshold was not increased in Scotland and remains at £500,000 and there is a de-minimis under which no independent scrutiny of accounts is required of £25,000 in England and Wales but no de-minimis at all in Scotland or Northern Ireland. We hope that the Commission will seek to work with other regulators and Government to bring about a more consistent approach so that there is a common understanding of what is meant by 'small' charities to which a lighter touch regime can be applied.
7. We believe that the consequences of the new Directions and guidance will be felt most keenly by small charities that are reliant on volunteer examiners or other pro bono input and that can ill-afford additional expense in relation to these matters.
8. If the Commission decides to amend the draft Directions and guidance along the lines suggested here, it could further help small charities by providing a tailored version so that charities can be provided with the appropriate Directions and guidance according to their size (in the same way that charities can download a version of the SORP which only contains the modules they need). In any case, we believe that more emphasis could be made of flow charts of the kind contained in Appendix 1 of the consultation document, to help small charities and their potentially unqualified independent examiners navigate through the complex requirements.

9. The Commission has only summarised the main changes made to the existing Directions and guidance in the consultation draft and we have not therefore tried to compare the two versions in detail or commented in detail on comparative advantages or disadvantages, although we welcome the fact that the Charity Commission has generally moved away from the previous approach of 'short answer' and 'more detail' which was unduly repetitive. As regards the consultation draft, there are a number of inconsistencies in the drafting, some of which we identify later in this response. We suggest that the entire draft should be reviewed to ensure that any issues of this kind are addressed; it is important that the Directions and guidance are unambiguous and simple to apply.
10. With regard to the sections of the guidance on reporting matters of material significance or relevant matters to the Commission, we refer to our response ([Representation 133/16](#)) to the recent consultation on the list of matters issued by the three UK regulators and do not repeat here the comments we made there. While we welcome the joined-up approach of the regulators as regarding the list of matters, it is unclear to us why guidance on this issue should vary greatly between regulators or, therefore, why the consultation on the list could not also have covered any guidance relating to it. It seems premature to be asked to comment on this guidance, when the outcome on the consultation on the list of matters to which it relates is unknown. It is also unclear to us whether the list of matters will be a self-standing document, in which case the matters do not need to be repeated in CC32, or whether they will simply be as set out in the new CC32 when it is finalised.

RESPONSES TO SPECIFIC QUESTIONS

The proposed new Directions

Q1: Do you agree that the proposed Directions are phrased in a way which is clearer to understand and follow? If you answered no, please explain how the phrasing of the Directions can be improved.

11. Please see our introductory comments and additional comments in an Appendix to this representation.

Q.2 Do you agree that the 3 additional Directions are appropriate? If you answered no, please explain how the phrasing of the Directions can be improved.

Direction 2 (conflicts of interests for the examiner)

12. We agree that it may be helpful to have a Direction on this issue and that guidance is needed to supplement it. However, we believe that the drafting of the guidance is unclear and too restrictive, for instance, equating membership of a committee with 'day to day involvement' (para 2.5) and requiring the trustees to approve the accounts before an examination is begun (2.3). These provisions have widely been interpreted to mean that practices that are common and helpful to the sector at present would be prohibited. For instance, a volunteer independent examiner may participate in sub-committees and so provide useful financial know-how to the board and may find errors or gaps in the accounting records as an independent examination progresses and help the charity rectify them. This help goes beyond mere 'formatting' of accounts. While trustees would be expected formally to sign-off the accounts before the independent examiner formally signs-off the independent examination, the interaction between the two before this stage is more iterative and the trustees (or staff) may make corrections to the accounts as the independent examination progresses. This can be in the interests of the charity and the sector as a whole and unless the Commission intends to prohibit this sort of interaction in future, the guidance should be revised. We have included more detailed comments on this issue in the Appendix.

13. Where large charities are concerned, the independent examiner will be subject to conflict of interest rules of the applicable recognised body. If the Commission can satisfy itself that the applicable rules are likely to provide sufficient safeguards, as one might expect the rules to do, then it would simplify matters if the guidance could reflect this.

Direction 7

14. The statutory duties of an independent examiner relate to reporting on the accounts (which are required to disclose conflicts of interest in the sense of related party transactions) but the wording of this Direction appears to go beyond that.

Direction 9 (check financial sustainability and going concern)

15. As noted in our introductory comments, this is a significant addition to the scope of work required by independent examiners. The requirements on financial sustainability appear to extend the scope of the independent examination beyond that envisaged in The Charities Act 2011 and the examiner's reporting duties in The Charities (Accounts and Reports) Regulations 2008. The Regulations also refer to the requirement for the accounts to give a 'true and fair view' but that is the responsibility of the trustees and explicitly excluded from the reporting duties of an independent examiner. The Regulations do not use the term 'going concern'. There are various aspects of the Direction and guidance that, in practice, are likely to be unworkable for non-qualified independent examiners, in particular, the requirement for the independent examiner to check that the trustees have carried out an assessment of going concern that meets the requirements of the applicable SORP including assumptions regarding going concern.
16. We suggest that this Direction should be reconsidered. We note that Direction 8 (review of estimates, judgements and accounting policies) already requires the examiner to consider, in the case of accruals accounts, whether the going concern basis is appropriate so we do not see the case for an additional Direction on this issue. Nevertheless if the Direction is retained we suggest it applies only to larger charities and that guidance be tailored accordingly. It certainly isn't possible for an examiner of receipts and payments accounts to carry out the sort of financial sustainability check that is suggested purely in the course of reporting on the accounts. It would also be helpful if the guidance, particularly where aimed at small companies, could link the requirements back to the requirements of the underlying Regulations.
17. If these concerns are not addressed, we believe that it may lead to a reduction in the number of independent examiners (whether or not qualified accountants) who are prepared to act on a voluntary or non-commercial basis. It is also possible that professional accountants will consider that it would be appropriate for them to have audit skills and experience to comply with this Direction where accruals accounting applies, in which case the pool of suitable examiners would be further reduced.

Q.3 In reviewing the other Directions, do you agree that they are improvement over the existing Directions and what changes (if any) would you recommend? Please give your reasons why.

18. Please see our introductory comments.

The proposed guidance for each Direction

Q.4 Do you agree with the contents of the guidance which follows each of the Directions and what changes to the guidance (if any) should be made and why? Please give your reasons in support of your suggestions.

19. Please see introductory comments. We do not believe that the application of the defined term 'should' to the guidance generally is helpful and would prefer it to be made clear that the guidance is not mandatory but recommended to help ensure examiners meet the requirements

of the Directions, with an acknowledgement that the examples cannot meet all circumstances, as is the case under the current Directions and guidance.

New format for the examiner's report

Q.5 Do you agree that the example independent examiner's reports are an improvement and what changes (if any) would you suggest? Please give your reasons in support of your suggestions.

20. We feel the examples are helpful, though we are slightly unclear on the purpose of the final phrase which refers back to the Directions of the Commission. The Directions cannot, we suggest, require the examiner to report on additional matters beyond the reporting duties in the 2008 Regulations.

21. We welcome the new format of report. It has the approach now normally used in audit reports of stating the basis of the review and then giving a simpler overall statement. We believe it will be more helpful for users of charity accounts.

Q.6 Do you agree that the example independent examiner's reports meet all the legal requirements and what changes (if any) are needed? Please give your reasons in support of your suggestions and state which regulatory requirement(s) are not being met.

22. We have no specific comments, but as many charities subject to independent examination are now structured as CIOs it would help if one of the non-company examples could be for a CIO.

Reporting of matters of material significance

Q.7 Is the guidance in appendix 7 for each of the listed matters of material significance helpful, and how might it be improved? Please provide reasons for your answer.

23. Please see introductory comments. We welcome the greater clarity provided in Guidance paras 4.9 and 5.6 that notifying the Commission would not of itself constitute tipping off. However, we think that further explanation should be provided as to how this conclusion has been reached or that the National Crime Agency or other relevant authority should publish a confirmatory statement to make the position more certain.

New guidance on the reporting of 'relevant matters'

Q.8 Is the new section on reporting relevant matters to the commission helpful and if you answered no, how can it be improved? Please provide reasons for your answer.

24. Please see our introductory comments.

Consolidated (group) accounts and independent examination

Q.9 Do you agree that the Directions and guidance for independent examination should be extended to consolidated accounts. Please give your reasons why.

25. We agree that the Directions and guidance should be extended to consolidated accounts, but as there will be relatively few relevant charity groups affected by this, we recommend that the applicable requirements be kept separate so as not to further lengthen and complicate the Directions for the vast majority of charities.

Q.10 Do you agree that if the Directions and guidance are extended to consolidated accounts that the only modifications are those listed and if you answered no, what further modifications are required? Please give reasons for your answer.

26. The Directions would need to cover relevant issues such as intra-group transactions.

Consideration of regulatory burdens and other comments

Q.11 Do you agree that the proposed changes to Directions and guidance to independent examination will not give rise to significant additional burdens on examiners and trustees and if you answered no, what are the additional burdens? Please give reasons for your

answer and if you have identified significant additional burdens, please express them in terms of the additional time to be spent and/or additional items of cost that will be incurred.

27. No, we believe that the new Directions and guidance will result in significant additional burden for the reasons outlined above. This is likely most to impact smaller charities who are reliant on volunteers in relation to accounting and independent examination.

Q.12 Do you have any other comments on the exposure draft Independent examination of charity accounts: Directions and guidance for examiners (CC32)? If so, please state the part of the exposure Draft you are considering and set out your comments with supporting reasons as to why a change is needed.

28. We have provided some more detailed comments in the Appendix.

29. As noted in our introductory comments, there are a number of inconsistencies in the drafting. We note a couple of these below and more in the Appendix by way of illustration, but the concern is a more general one that insufficient rigour has been applied to the drafting generally and we recommend that the Commission review the entire document to ensure that any issues such as this are addressed.

- On page 5 in 'Independent examination at a glance' it is stated that an item in the accounts is only checked against an original document such as an invoice or receipt 'where significant concerns are identified from the work of the examiner, or where satisfactory explanations cannot be obtained from the trustees.' But in the guidance for Direction 4, para 6.6, it states that there is 'no requirement for all accounting entries to be checked against source documents (e.g. invoices, supplier statements, purchase orders, Gift Aid records etc) unless concerns arise during the course of the examination or following the analytical review (Direction 11) matters are identified which cannot be resolved by simply seeking explanations from the trustees, or where appropriate the charity's staff, or the explanations given are insufficient.' This suggests that if any issue arises, then **all** accounting entries need to be checked, which is at variance with the requirement on page 5 (and, we would suggest, incorrect).
- We have commented above on the general implications of Guidance para 2.3 in relation to Direction 2, but it surely cannot be right to say that 'trustees are responsible for the accounts of the charity and so they must still review and approve the accounts once compiled before you start your examination'. It does not make sense for the trustees to sign the accounts before the examiner has begun the examination as this would not allow for corrections to the accounts that will be needed as a result of the examination or allow of the possibility of adjusting for post balance sheet events. This is also expressed as a mandatory requirement ('must'). The guidance should simply state that the examination cannot be *concluded* (i.e. the examiner cannot sign his/her report) until the accounts have been approved by the trustees,

Q.13 The new Directions are intended to take effect for reporting periods (financial years) ending on or after 31 March 2017. Do you agree that this effective date is reasonable and if you answered no, what alternate date would you suggest and why?

30. No, we believe a longer period should be allowed because if independent examiners decide to resign or introduce or increase charges for their services in light of these changes, time should be allowed for charities to make appropriate adjustments to their arrangements. We also believe that, if the new Directions and guidance are to cover reporting matters of material significance, they should reflect the outcome of the consultation on the list of material matters. The possibility that the Directions will require substantial amendment in light of the consultations should not be discounted, or the possibility that a further round of consultations might be desirable if extensive amendments are going to be made. This will particularly be the case should a new Direction be introduced relating to the voluntary consolidation of accounts.

APPENDIX

Additional comments

Direction 2

The 'plain English style' results in an inconsistent use of pronouns. For example, in paragraph 2.1 'their' and 'you'. The whole document needs to be consistent on addressing the examiner as 'you' or referring to the examiner in the third person.

The guidance in paragraph 2.3 is critical when applied to the smallest charities.

The guidance on conflicts covers (in 2.3) 'self-review' amongst a variety of potential conflicts of interest, but the issues arising regarding self-review involve consideration of a number of issues arising elsewhere in the guidance, in particular in the Introduction and Directions 5 and 6 (for instance regarding responsibility for financial record keeping and 'vouching'). The descriptions involved are not always consistent and it would be helpful if this issue could be covered in a consolidated and consistent way.

It might be helpful to clarify that a professional, regulated firm, might act as book-keeper and also act as independent examiner (where permitted by its ethical rules).

Is the use of the word 'formatting' in the second sentence deliberate? The accounts are described as 'compiled' later in the same paragraph and, in other Directions, accounts are described as having been 'prepared'.

Direction 3

The eighth bullet point of paragraph 3.1 spells 'compiled' as 'complied'. What is meant? 'Compiled', or 'assisted with formatting', or 'prepared'? Under 'Legal references' 'relevant' has been used where 'relevance' is meant.

Direction 4

There are changes in wording in paragraph 4.1 from 'The steps taken by an examiner would normally include' [current version] to 'The steps taken by an examiner should include'. Given the proposed change in the meaning of 'should' the bullet points that follow become over-bearingly prescriptive and a number of the requirements, for instance the second bullet point, then appear to call for work that might be more appropriate for an audit than an independent examination. In the preamble to this draft revision of CC32, 'Independent examination at a glance', whilst acknowledging that an examination 'is a simpler form of scrutiny than an audit', it goes on to state 'it still provides trustees, funders, beneficiaries, stakeholders and the public with the assurance that the accounts of the charity have been reviewed by an independent person'. It acknowledges that the examination is a less onerous form of scrutiny than an audit but this is not clear from the drafting. The Directions should not imply that the examiner's review can do anything other than what the law specifies. The existing CC32 makes it clear that the assurance is 'about specific matters'.

Paragraph 4.4 states that, in the event of a lack of formal trustee meetings etc, the examiner 'should [new meaning] confirm or discuss significant matters with 2 [sic] or more trustees' whereas the current guidance says 'may' rather than 'should'. This is unnecessarily prescriptive and quite likely disproportional in many cases involving smaller charities.

Direction 5

Paragraph 5.2 refers to records 'or' vouchers; why not 'and'?

Direction 6

Whilst, in the existing guidance, the examiner must be satisfied, 'where transactions relate to restricted or endowment funds, that these have been properly recorded and identified in the accounts', paragraph 6 .1 introduces the further requirement that 'these have been properly spent

in accordance with the specific purposes of those funds'. Surely this is going beyond the relatively straightforward, but fundamental, requirements of this Direction and, in any case, is outside the scope of the legal requirements of an independent examination?

To avoid using the word 'properly' twice the guidance requires that the examiner would now have to check the 'accurate' recording.

Paragraph 6.7 acknowledges that, on occasion, the examiner may [sic] also prepare the statutory accounts. Please refer to comments on paragraph 2.3 (above).

Paragraph 6.7 also repeats the new requirement that the trustees approve the accounts before the work on the examination commences. We have commented on this in the context of para 2.3.

As it is simply repetition of guidance in other Directions paragraph 6.7 could be deleted without removing anything from the Directions and Guidance generally.

Direction 7

Does paragraph 7.3 mean what it says by 'In England and Wales there is no requirement for notes to the accounts'? Surely this comment only applies to receipts and payments accounts?

Is there really a place in these Directions, addressed to independent examiners, to state that notes to the accounts are 'good practice'? The examiner is not responsible for the accounts and why should an examiner get involved in non-statutory disclosures?

Similarly paragraph 7.5: 'such disclosures are evidence of good practice'.

Direction 8

In paragraph 8.5 it seems unnatural to refer to 'the FRS 102' rather than simply 'FRS 102'.

The title of Direction 8 could also make reference to the work required in respect of fund accounting (the first bullet point). With regards to this first bullet point, which is new, is there a real, significant and sufficient distinction between 'correctly accounted for' and 'reported correctly' such that both must be separately checked?

Direction 9

Paragraphs 9.5 to 9.7 will serve to increase the need for more input from professional firms and so increase the compliance costs of charities across the board.

Direction 10

The first bullet point of Direction 10 requires that the examiner must check that the funds of the charity are correctly identified. Isn't this covered by the new, first leg, of Direction 8?

Direction 11

'Reasonable assurance' is an audit term and so should be avoided in the context of an independent examination. The requirement in the Direction for the matter to be referred to in the independent examiner's report should the examiner be unable to obtain 'reasonable assurance' is new and either unnecessarily prescriptive or stating the obvious but in any case rules out the application of professional judgement.

Paragraph 11.5 again makes the leap from, currently, procedures 'would normally include' to 'should' which becomes mandatory given the new meaning.

Appendix 3

The Appendix states that 'Any person with financial awareness and numeracy skills should have the requisite ability to act as an independent examiner for receipts and payments accounts.' But a number of the provisions are more demanding than this and it is, ultimately, unclear how trustees

could be satisfied that a person other than a qualified accountant, or possibly a specialist charity accountant, could meet the criteria. For instance, it is also stated that 'the examiner needs some familiarity with certain basic principles including the different types of income funds (unrestricted and restricted) and capital funds (permanent and expendable endowment), the nature of trusts, the responsibilities of trustees, and the role of the charity's governing document' and that: 'For accruals accounts the examiner should be a skilled person, who demonstrates a good understanding of accountancy principles, accounting standards and knowledge of the applicable SORP'. If a wide pool of examiners, including volunteer examiners, is to be maintained, the drafting of these provisions might be reconsidered to make clearer that the level and nature of knowledge and experience required will depend upon the nature of the charity in question.