



REPORTING MATTERS OF MATERIAL SIGNIFICANCE TO A UK CHARITY REGULATOR

ICAEW welcomes the opportunity to comment on the Invitation to Comment on Reporting Matters of Material Significance to a UK Charity Regulator published by the charity regulators in England and Wales, Scotland and Northern Ireland, a copy of which is available from this [link](#).

This ICAEW response of 8 September 2016 reflects consultation with the ICAEW's Charity Technical Sub-Committee of the ICAEW Business Law Committee. This Sub-Committee includes representatives from public practice and the charity sector and is responsible for ICAEW policy on charity issues and related submissions to legislators, regulators and other external bodies.

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MAJOR POINTS

1. The list has the advantage of making it clear in practical terms what matters the regulators expect auditors and independent examiners (referred to collectively as ‘reviewers’ in this response) to report to them.
2. However, this list is prescriptive in nature (being a list of matters that ‘should’ be reported) and it is not clear to us how this reflects the statutory basis for the requirements. The statute only requires a reviewer to report a matter which the reviewer has ‘reasonable cause to believe is likely to be of material significance for the purposes of the exercise by the Commission of its functions...’, a formula that appears intended to involve the exercise of judgment on the part of reviewers.
3. In many cases the distinction will be an academic one. For instance, where there is dishonesty or fraud involving a major risk to fund assets, it would be natural to conclude that this would meet the test of material significance. In practical terms it makes little difference whether the regulators list this as a matter that ‘should be reported’ or simply identify it as one of the matters that would be of material significance in the exercise of their functions.
4. However, in some cases the list includes matters that would not normally be considered to be of material significance in themselves, for instance matters of emphasis in accounts (which might relate simply to technical accounting reporting matters) or matters drawn to the attention of the trustees that remain un-remedied (which might be low priority matters).
5. While the guidance says that matters of this kind should be reported, it does not explain why. The statutory requirements only apply to matters of which the reviewer becomes aware ‘in the course of acting in the capacity mentioned’. They do not require reviewers to carry out additional work which might increase the scope of any review. We believe that it would be helpful for the guidance to explain in more detail how, in practice, the regulators would use the information concerned in the exercise of their relevant functions.
6. This would be particularly helpful in the context of information that is not obviously of material significance in itself, but which the regulators might simply find ‘useful’. We suggest that reporting of information of this kind should be described as information that ‘might’ be of material significance rather than information that ‘should’ be reported, so that reviewers can exercise discretion on whether or not to report based on all relevant circumstances and their statutory duties. There is a separate power for reviewers to make non-mandatory disclosures and it would, in any case, be helpful to have guidance in that respect as well as in relation to mandatory disclosures.
7. It would be helpful if the guidance were to confirm that matters would only need to be reported where there is sufficient concrete evidence to reach the relevant conclusion, so that matters of speculation or hearsay arising during the review would not in themselves suffice as the basis for a report. Some of the terminology used in the list is open to doubt in that respect (such as ‘matters suggesting’ and ‘knowledge or suspicion’).
8. The Charity Commission has issued a separate consultation on its Directions for independent examiners (CC32) which includes guidelines on the list of matters. We do not generally comment on that document here, but a number of the issues raised will be relevant to that consultation.

RESPONSES TO SPECIFIC QUESTIONS

Q1. The list of material matters of significance which must be reported was developed to aid auditors and independent examiners in understanding their duties under the legislation. Do you agree that it is useful to have a list of matters which must be reported? If not, what

means do you suggest of helping auditors and independent examiners meet their statutory duty to report?

9. We agree that it is in the interests of the sector for the charity regulators to provide guidance in this area but, as noted in our introductory comments, it is not clear why it should be supposed that all of the matters listed would meet the significant materiality test. It would be helpful if more information could be given on how the regulators exercise their relevant powers and how they would use information provided in that context. Further consideration could then be given as to whether all the matters should be listed as reportable or whether reviewers should be free to exercise their discretion in some cases.

Q2. Do you agree that the descriptions of the matters to be reported are clear and helpful? If not please advise where further clarity is required.

10. We comment on some specific issues (for instance regarding materiality) further below. Otherwise the descriptions are generally clear but, as noted above, it would be useful if explanation could be provided on how the information would be used by the regulators in the exercise of their powers, including what weight might be accorded to particular issues.

Q3. The terminology in Matters 1 and 2 has been amended to agree to that used in the Statement of Recommended Practice for Charities (SORP), do you agree that this is helpful for consistency? If not please advise what terminology you would recommend and why?

11. While we appreciate that the changes are intended to be helpful, we think that they require further consideration or explanation. The term 'material' is used (and explained) in the financial reporting standards and SORP for the particular purposes of those documents and in relation to accounting matters. The context here is different, because the statutory reporting requirements relate to matters of material significance to the regulators in discharge of their functions. We do not, therefore, think that anything is to be gained by seeking to attribute a SORP related meaning to the term, indeed, it might lead to confusion. Of course, 'material' has a natural meaning and is a term used in the relevant statute (material significance). It might, therefore, serve the purpose as well as the previous term 'significant', but we suggest that guidance should make clear that it is not intended to have a technical accounting related meaning or that further guidance as to what the regulators consider to be materially significant is given.

Q4. Matter 3 has been expanded to specifically include the charity's bank account in the areas where funds could be used for money laundering. This is based upon our experiences where the charity's bank account has been used to move money. Do you agree that the expanded definition is helpful? If not please advise what alternative definition you would use.

12. It is helpful that the guidance reflects the regulators' experience in matters such as this. However, there is a broader point arising from Matter 3 concerning tipping off. Charity Commission guidance CC32 (June 2015) notes that it 'is not expected' that reporting to the Charity Commission will constitute a tipping off under Money Laundering Regulations. The consultation revised draft CC32 says that reporting would not constitute tipping off. However, as tipping off is a criminal offence, reviewers can be expected to exercise caution in this respect and we believe that some firms do not currently report matters to the Charity Commission because of concerns in this area. It would, therefore, be helpful if more explanation as to why reporting would not constitute tipping off could be given.

Q5. Matter 4 is now applicable to Northern Ireland and has been expanded to exclude the need to report any matters that were related to a qualifying offence as defined by Section 3(7) of the Northern Ireland (Sentences) Act 1998. Do you agree that the matter should be expanded in this way? Do you consider that the proposed wording is appropriate? If not please explain your answer and advise what alternative wording you would use.

13. The change relating to Northern Ireland is of a very specific nature, more in keeping with legal regulations than guidance and implies a level of familiarity with specific regulations that seems misplaced in this context, particularly for independent examiners. If it is retained, it would be helpful if the guidance could give more explanation as to its purpose. We do not know how many reports might be made absent this provision, but assume that they would be few in number (at least for charities outside Northern Ireland) and we wonder whether such a specific provision is merited in this context. It might be preferable if the underlying intent could be expressed in a more generic way (for instance with regard to spent crimes or the like).

Q6. Matter 8 from the previous list of matters to be reported has been removed. This is due to the fact that this led to auditors and independent examiners advising the Regulator where they had simply ceased to hold office. Where ceasing to hold office occurs due to a reportable matter this should be covered by an alternative matter. Do you agree that this matter should be removed? If not please advise why it should be retained?

14. We agree that appointments of auditors and independent examiners might cease for perfectly benign reasons and that the matter listed should be removed. It seems likely that a cessation linked to matters that would be significantly material would be covered by the other matters listed..

Q7. Matter 9 has been introduced to ensure that auditors and independent examiners report to the charity regulator as soon as they issue a modified audit opinion (including any emphasis of matter) or qualify their independent examiner's report and notify the regulator . Separate notification enables the matter to be considered for regulatory action and avoids any delay arising from awaiting the filing of the charity's accounts. This will be useful to the regulators as there have been a number of instances where matters have not been reported separately but simply included when the auditor's or examiner's report is qualified. Do you agree that the inclusion of this within the matters of material significance will assist auditors and independent examiners? Please give your reasons for this response.

15. We do not agree that all modified audit opinions (including emphases of matter) should be reported. Modified audit opinions (particularly emphases of matter) may result from relatively technical matters that are not in themselves indicative of material concerns about the charity or its finances. For instance, an independent examiner's report may be qualified (not just subject to an emphasis of matter) if there have been failures in bookkeeping by the charity resulting in some uncertainty about some of the figures, but where there is no suspicion of fraud or the like. If the trustees have agreed to rectify their practices for the following year, it is difficult to see why this should be a matter for whistleblowing. The proposed approach (if followed) will inevitably result in reporting where the auditor/examiner does not believe that the report will be of material significance for the regulators and we question whether this is consistent with the requirements of the statutory framework. The fact that information might be 'useful' is not in itself sufficient to drive potentially onerous reporting requirements.

16. While reviewers are able to explain to charity clients why a modified opinion may be required and allay concerns where the modification results from technical issues, it may be difficult to explain why the regulators should need to be notified in these circumstances; reporting is likely to be perceived as something associated with possible wrongdoing by charities. This could lead to friction between reviewers and their clients and pressure on reviewers not to make modifications, with potentially adverse impact on the market and market practices.

17. We suggest that variations from a clean audit/IE opinion should only be reported if material in terms of the statutory requirements and that the regulators should provide guidance on the sort of circumstances when this will be the case, for instance where the matter in question is likely to lead to a loss of charity funds or a bookkeeping failure amounts to a significant failure to keep adequate books and records.

Q8. Auditors regularly offer guidance and areas for improvement to their clients. We recognise the important role this plays in ensuring charities meet their regulatory requirements. Where charities fail to act upon the recommendations made by their advisors this may be an indication of governance concerns and should be reported to the regulator. Do you agree that this matter should be included as a reportable matter? If not please provide your reasons for this.

18. Again, we do not believe that this matter should, in itself, be reportable. Similar issues arise in this context as for the preceding question. The fact that a charity may not have acted on a recommendation is not necessarily a cause for concern or indicative of bad governance. A low priority matter may, or may not, remain so for a long period and may never become a matter of material concern, irrespective of whether or not there were target dates for addressing it.
19. It will be important for charities to understand what the regulators will do as a result of any reports of this kind. For instance, will the relevant charities be on some kind of 'watch list' and will they be expected to justify why they have not taken the action in question?
20. The above question refers to 'guidance and areas for improvement', whilst the comment alongside the requirement in the consultation document refers to management letters. If the requirement applies only to communications designated as 'management letters' it is possible that reviewers may provide the guidance by other means, possibly at the request of their clients. But if the requirement applies to information however communicated, it could be intrusive and difficult to manage and control and might result in large volumes of essentially trivial disclosures that would take resource of regulators to assess. In either case, there is a risk that the requirement will impede the free exchange of views that might otherwise take place, which would not appear to be in the interests of the sector.
21. Guidance will reflect the views of the reviewer, but the charity may not agree with these views. There is a risk that trustees may, in some cases, take a course of action with which they do not agree simply to avoid being reported to the Charity Commission.
22. Matter 10 on the list envisages that the trustees would not need to take the relevant action if they have 'reasonable cause' not to do so. It would be helpful for guidance to be provided as to what might constitute a 'reasonable cause'. For instance, would evidence that the trustees did not agree with a recommendation suffice?
23. A charity may change its auditor or independent examiner and the new reviewer may not share the previous reviewer's view on areas for improvement. Any guidance on this should make clear that the new reviewer would have no reporting obligation in that context (and neither would the previous reviewer who would not be expected to have ongoing monitoring obligations). Again, the potential effect of provisions of this kind on the market should be taken into account.
24. We appreciate that some sectors (for instance academies) may need to make reports to their regulators in these sorts of circumstance, but in those cases there will typically be additional factors justifying this approach, for instance where the regulators are, in effect, major funders.
25. Some matters may be drawn to the attention of the trustees as representing best (as opposed to acceptable) practice but which are not necessarily going to result in material loss to the charity or other matters of concern. If the reviewer has drawn the attention of the trustees to this and the trustees have advisedly decided to continue their practice, why would this be a matter of concern for the regulators?
26. Any Freedom of Information Act implications of requiring more extensive information to be disclosed to a body such as the Charity Commission (to whom the Act applies) will need to be taken into account.

27. We suggest that any reporting requirement on these lines should be subject to a materiality test, for instance, the words ‘and that expose the charity to significant risk’ could be inserted at the end and that further guidance should be provided to reflect the comments made in our response. It may be, however, that Matter 2 (reporting on internal control weaknesses) would substantively cover the underlying concerns, in which Matter 10 would not be required.

Q9. It is important for public trust in charities to ensure that all relationships are properly managed in accordance with charity law and where required disclosed in order to maintain public trust and confidence. Matter 11 highlights the need for auditors and independent examiners to report to us where they believe that relationships are not managed well or are not correctly highlighted to users of the accounts. Do you agree that this should be included as a matter of material significance? If not, please provide your reasons why.

28. Matter 11 only covers specific aspects of the relationships referred to in this question. The matters would be covered in the audit report in appropriate cases (and in this case would be already covered by Matter 9). In other cases, these issues would typically be addressed through a management letter and may not be considered material. We suggest, therefore, that any additional reporting requirement should only apply where the issue is sufficiently ‘material’ and that guidance should be provided as to when this might be the case.

29. The requirement for conflicts to be managed ‘in accordance with guidance issued by the charity regulator’ is also too prescriptive as independent examiners should not be expected to be aware of all of the changing body of guidance in this area; onerous requirements of this kind may deter independent examiners from accepting the role, particularly if they are not qualified accountants. We suggest that the types of conflict of most concern to the regulators could be identified (along the lines of the comments to this requirement in the consultation document).

Q10. While the reporting requirements have not changed significantly we have increased the areas identified as matters of material significance to provide clarification for those with reporting responsibilities. Do you agree that this aids clarification and is not a significant increase in regulatory burden? If not please provide your reasons for this.

30. We believe that the new requirement in Matter 9, in particular, increases the regulatory burden and could result in a lack of clarity as to why the disclosures are required (in the light of the statutory requirements). This is, however, just one example and we believe that more explanation could be given generally as to how the listed matters relate to the statutory requirements, as noted in our earlier comments.

Q11. In addition to the matters identified as reportable, we have received feedback that some further guidance around reporting requirements, including more practical examples of reporting matters of material significance would be useful. Do you agree that further guidance in this area is required and if so should this be provided by the regulators and/ or included in auditing standards?

31. Yes. As noted in our introductory comments, we believe that the regulators should provide practical examples of matters that they consider of material significance for the purpose of the exercise by them of their functions specified by the Act. The list of matters of particular relevance to reviewers could then be seen in the wider context.

Additional Comments

32. With reference to Matter 5 and the change referring to evidence obtained ‘during the audit/independent examination’, the statute already provides that the reporting requirement only applies in relation to matters of which the auditor/independent examiner becomes aware ‘in the course’ of acting in the relevant capacity and it might be better to preface the whole list with this proviso.

- 33.** Also in relation to Matter 5, we are concerned about dual reporting requirements, accountability and application of skill and experience. An auditor is not necessarily trained to assess signs of risk or abuse in relation to care and welfare of individuals and it is unclear what aspects of the audit/independent examination would be expected to reveal the sort of information sought and that the regulators do not expect reviewers to undertake any work in relation to this matter that would not otherwise be within the scope of their engagement.
- 34.** In light of the new regulations in the area, it might be helpful for the regulators to provide guidance on aspects of fundraising and potential abuse that they would consider to be materially significant in the context.