Charity reporting: rule changes on reporting material significance

Joanna Pitman, partner at Sayer Vincent, reviews compliance issues under new charity reporting regulations concerning matters of material significance, which are effective 1 May 2017 regardless of the accounting period being reported on

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The three UK regulators of charities, the Charity Commission for England and Wales, the Office of the Scottish Charity Regulator and the Charity Commission for Northern Ireland, have released a new guide for auditors and independent examiners to outline and explain reportable matters. The new regulations will impact auditors and independent examiners of charities with a duty to report matters of material significant to the regulator.

The regulations apply from 1 May 2017, regardless of the accounting period being reported on. Any audit work undertaken from 1 May 2017 and any audit reports signed off from 1 May 2017 will fall under the regulations.

What must be reported?

The regulators have produced a list of matters of material significance that must be reported on. These include any matters that have the potential to result in loss of or risk to charitable funds or assets, whether by potential dishonesty or fraud or through the failure of internal controls, including matters of governance.

The regulators must be notified of knowledge or suspicion that charitable funds or resources have been used for money laundering or to support terrorism.

It must also be reported if there is any evidence that the charity's activities put its beneficiaries at risk of abuse or mistreatment or there are any breaches of legislative requirements, including charitable funds being misapplied or any evidence of a deliberate or significant breach of an order or direction made by a charity regulator.

There are also two new requirements to report under this regulation. Firstly, there is the requirement to report on where an auditor's or independent examiner's report is modified, or contains an emphasis of matter paragraph. Secondly, if there are any concerns that conflicts of interest and related party transactions have not been properly managed or declared.

What has changed?

The original guidance was first published in March 2012. One of the reportable matters not included on the new list relates to reporting any circumstances about ceasing to hold office or resigning as auditor. However, this remains a requirement under the Charities Act 2011 and Charities and Trustee Investment (Scotland) Act 2005.

Under this legislation, if a statement of circumstances is made to the trustees of matters that should be brought to their attention, a copy should be also sent to the charity regulator. So, despite this no longer appearing on the list, a duty to report any matters when resigning as auditor remains.

There are two new reportable matters, relating to modified audit or independent examiner reports and management of conflicts of interest.

Any modifications, whether a disclaimer, qualification or emphasis of matter paragraph in an audit report or matters disclosed in an independent examiner's report, must be reported to the charity's regulator. An emphasis of matter paragraph does not modify the auditor's opinion, but draws the reader's attention to something important for them to understand about the financial situation of the charity.

An auditor must present a report to the regulator on all modified opinions and paragraphs, with the level of detail proportionate to the severity of the issue leading to the modification or paragraph. The report needs to explain the nature of the matter and any actions being taken by the trustees in relation to it.

An independent examiner is required to report the details of their qualified examination report to the regulator.

Going concern

A common issue for charities relates to financial sustainability. The trustees need to explain any material uncertainties that impact on going concerns in the accounting policies. The auditor may agree that the charity is a going concern, but feel that the disclosures made by the trustees are important in helping them understand the financial situation and explain why the going concern basis is appropriate. The auditor may conclude that their opinion is unmodified but include a paragraph in the audit report to draw attention to the trustees' disclosures.

In this situation, a report will need to be made to the charity regulator to notify them of the matter being emphasised in the audit report.

In practice, in modifying an audit report, the auditor will be required to disclose and explain the modification. Therefore, the auditor could provide a copy of the audit report or the modified paragraphs to the regulator. The additional information must include details of the action being taken by the trustees. It is highly likely that the auditor will have discussed the modifications with the trustees before the report is finalised to understand what steps they will take to resolve the issue.

Conflicts of interest

The charity regulators have issued guidance on how conflicts of interest should be managed and the Charity SORP (FRS 102) requires disclosure of certain related party transactions in the financial statements. The charity regulators want to be notified if there is evidence conflicts of interest have not been managed by the trustees in accordance with the guidance or if related party transactions have not been fully disclosed.

Auditors and examiners should also consider if the charity's governing document has details on how transactions with related parties should be managed and whether the charity is compliant with this.

The example in the guidance relates to setting the remuneration of a trustee or a person related to the trustee. Mismanagement may be indicated if the trustee with the conflict of interest is present at the discussion or participates in the decision about remuneration. This may be difficult for an auditor or examiner to identify.

Examples of indicators to look for could be the absence of a policy on managing conflicts of interest or absence of appropriate discussion and decision in the board minutes.

Reporting

Auditors or independent examiners must report to the charity regulator immediately when they become aware of a matter of material significance. If the matter relates to a modified audit or independent examiner's report, the report should be made when the report is signed. This will ensure the regulator is aware of the modification straight away, rather than waiting for the charity to file the accounts, which could be several months later.

The written report should be made to the regulator the charity is registered with and where its accounts are filed. If charities are registered with more than one regulator as they operate in more than one jurisdiction, the report should be made to all relevant regulators.

Charity trustees

Charity trustees need to familiarise themselves with the matters of material significance and the duty on the auditor or independent examiner to report these matters to the regulator. You should appoint an auditor or examiner who is able to perform a competent review of your accounts. If you identify one of these issues in your capacity as trustee, consider if this constitutes a 'serious incident' or 'notifiable event' and whether it should be reported to your charity's regulator.

Top five tips for auditors

1. The new guidance is effective from 1 May 2017. This means that even if the audit work was done before 1 May, if the audit report is signed after 1 May, you should consider if there was a matter of material significance to report.
2. Make sure your audit staff are aware of the new guidance – what the reportable matters are and that the requirement to report is effective immediately, regardless of the accounting period being audited. The guidance is 42 pages long, but auditors should read it in full and confirm that they have done so.
3. Update your audit programme - make sure you have a prompt to consider if there are any reportable matters. All members of the audit team should consider if there are, although ultimately the senior statutory auditor will probably be the one to make the report. Appendix 1 of the guidance has an optional checklist that you may choose to use to help you document matters identified, evidence found and whether or not you report.
4. Consider other regulators – if there is a matter of material significance to report to the charity regulator, there may be a matter to report to another regulator as well, such as your MLRO (money laundering reporting officer), National Crime Agency and/or the police.
5. Inform your charity clients – make sure charities are aware of your responsibilities as auditor and understand what the reportable matters are. Check that your engagement letter covers your responsibility to report to the charity regulator and other regulators as required.

FAQ: what must be reported?

The regulators have produced a list of matters of material significance that must be reported on. Starting with new items, these include:

- where an auditor's or independent examiner's report is modified, or contains an emphasis of matter paragraph (new)
- concerns that conflicts of interest and related party transactions have not been properly managed or declared (new)
- matters suggesting dishonesty or fraud involving loss, or risk to, charitable funds or assets
- failure(s) of internal controls, including matters of governance, that have or could result in loss or risk to charitable funds or assets
- knowledge or suspicion that charitable funds have been used for money laundering
- knowledge or suspicion that the charity, trustees, employees or assets have been used to support terrorism
- evidence that the charity's activities put its beneficiaries at risk of abuse or mistreatment
- breaches of legislative requirements, including charitable funds being misapplied
- evidence of a deliberate or significant breach of an order or direction made by a charity regulator

In England and Wales, refer to CC11 Trustee expenses and payments.

In Scotland, refer to Guidance and Good Practice for Charity Trustees.

In Northern Ireland, refer to Making payments to charity trustees.

Reports should be sent to the following email addresses :

In England and Wales: whistleblowing@charitycommission.gsi.gov.uk

In Scotland: section46@oscr.org.uk

In Northern Ireland: concernsaboutcharities@charitycommissionni.gov.uk

About the author

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