



Association of Accounting Technicians
response to The Charity Commission for
England and Wales, the Office of the Scottish
Charity Regulator, and the Charity
Commission for Northern Ireland “Invitation to
comment - Reporting Matters of Material
Significance to a UK Charity Regulator”

Association of Accounting Technicians response to Reporting Matters of Material Significance to a UK Charity Regulator

1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Invitation to comment published by the UK's three charity regulators on 19 May 2016.
- 1.2. AAT is submitting this response on behalf of our membership and from a wider public benefit perspective.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.

2. Executive summary

- 2.1. The revised guidance for auditors and independent examiners on reporting matters of material significance to a UK charity regulator focuses on a published authoritative list of such matters which are to be applied consistently within the three charity jurisdictions in the UK, based on improvements to the wording of the existing published list developed by two of the jurisdictions.
- 2.2. While AAT supports the proposed improvements in the guidance, there are concerns that the listing of matters should not be considered exhaustive and that auditors and independent examiners should be encouraged to consider other matters of material significance which it is in the public interest to be reported (see 3.1 below).
- 2.3. AAT is particularly concerned that it is not feasible to authoritatively define matters of "material significance" and highlights the need to recognise that auditors and independent examiners must apply judgment in assessing what is of material significance to users in the financial statements subject to their review (see 3.15 below).
- 2.4. AAT has considered that while the failure by a charity to act on recommendations made by the auditor or financial examiner (or other advisors) might be an indicator of a reportable matter, the failure to act in itself does not need to be reported (see 3.10 below).
- 2.5. Related party transactions form an important element of the audit or financial examination of charities' financial statements and AAT stresses the need to recognise the identity of related parties in the environment of charitable activities (see 3.13 below).
- 2.6. AAT recommends a minor change in the wording of Matter 3 in the listing in order to avoid any ambiguity (see 3.5. below) and clarification of the duty to report in the event of the resignation of an auditor or independent examiner (see 3.7 below) as well as prescribing the timing of reports to be made to the regulator (see 3.8 below).
- 2.7. AAT does not support the concept of the guidance being embodied in auditing standards (see 3.16 below).

3. AAT Response to the Consultation Document

AAT's responses to the specific questions raised in the invitation to comment are as follows:

Question 1

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?

- 3.1. It is considered both useful and desirable to provide a list of material matters of significance in order to provide guidance to auditors and independent examiners as to matters on which they have a statutory duty to report. While the list should be as comprehensive as possible, it should be presented as representing examples only and must not be considered a defence available to auditors or independent examiners who fail to report a matter which is not on the list but proves to be of material significance.
- 3.2. Material significance must be considered with regard to the impact on any users who rely on a charity's financial statements, especially the public at large. It is not feasible to provide a comprehensive definition of material significance particularly in relation to charitable activities. Moral and ethical misdemeanours or mismanagement by a charity may be considered of material significance by the users of a charity's financial statements and, where appropriate, reportable by the auditor or financial examiner. Going concern or solvency risks might also be considered to be of material significance.

Question 2

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

- 3.3. AAT agrees that the description of matters to be reported are clear and helpful, subject to clarifying that the list is not intended to be exhaustive as referred to in 3.1 above.

Question 3

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?

- 3.4. It is considered proper to endeavour to use terminology consistent with the charities' SORP for the avoidance of possible ambiguity or misinterpretation.

Question 4

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.

- 3.5. It is helpful to expand the definition under Matter 3 to specifically include bank accounts. However bank accounts form part of a charity's funds so the phrase "the charity or charitable funds **or** the charity's bank account(s) have been used" is not strictly correct. The word "including" should replace the latter "or" in the phrase.

Question 5

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.

3.6. AAT is content with the proposed expansion of the definition of Matter 4.

Question 6

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?

3.7. While accepting that Matter 8 should be removed from the list of matters of material significance to avoid possible misinterpretation, AAT suggests that the guidance should stress that the resignation of an auditor or independent examiner does not obviate the need to report any relevant matters which have already arisen, even if the audit or examination process has not been completed.

Question 7

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.

3.8. AAT agrees that the inclusion of Matter 9 within the matters of material significance will assist auditors and independent examiners as it clarifies that this is a separate duty. However, AAT recommends that the emphasis of the timing of reporting matters of material significance to the regulator should be amended to require reporting **as soon as is practicable** after the auditor or independent examiner has identified the matter and not link the timing of reporting to the formal process of the publication of financial statements (although there may be occasions when the two events coincide).

3.9. It should also be a requirement for the auditors' or independent examiners' report on financial statements to identify matters which have been reported to the regulator unless prohibited by law (such as money laundering suspicions).

Question 8

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.

3.10. Where charities fail to act upon the recommendations made by their advisors, the auditors or independent examiners should recognise this as an indicator that there could be a potential matter of significance to be reported. However, it should not be considered an automatic consequence. AAT considers it reasonable to expect that advice received by a charity may be targeted at improving efficiency rather than reflecting a material or significant deficiency. As a result, recommendations in respect of

the latter may not necessarily be capable of being put into practice, particularly for charities dependent upon volunteer support.

- 3.11. Furthermore, advice may be given not only by auditors or independent examiners, but also by other relevant professionals who may be employed on a professional basis or who may be benefactors of the charity. Frequently, members of a charity's management board or sub-committees may hold office because of their ability to provide professional advice to the charity, and it would be a matter of subjective consideration for an auditor or independent examiner to decide which advice, if ignored, gives rise to a matter of material significance, which needs to be reported.
- 3.12. The failure by a charity to act on a recommendation from the auditor or independent examiner should not be a reportable matter, but the potential consequences of failure to act need to be evaluated by the auditor or independent examiner, and if it is concluded that a matter of material significance is *likely* to arise, the matter should be reported. Just as the auditor or independent examiner has to make a judgment as to matters which are considered of material significance the same principle applies to making a judgment as to the risk of matters "likely" to arise.

Question 9

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.

- 3.13. The disclosure of related party transactions involving charities requires the same transparency and clarity of reporting as for any other public interest bodies (such as listed entities) but the definition of "related party" in respect of a charity requires careful consideration, particularly where there is a dependency upon volunteer support in undertaking the activities of a charity. The management by a charity of these relationships very much depends on the ethos of the organisation (and perhaps even the attitudes adopted by the key executives in the charity). Volunteers may be "rewarded" by "benefits in kind" which are not reflected in financial records and may be difficult to evaluate but could be considered to be materially significant.
- 3.14. Clearly contravention of the SORP for Charities in the proper disclosure of related parties' transactions in respect of matters of material significance must be reported to the regulator but other matters of potential material significance have to be subject to the judgment of the auditor or independent examiner with regard to the need to report, in a similar way as referred to in 3.10 above, in that any matter deemed reportable would be expected to be the subject of advice to the charity by the auditor or independent examiner if they have concerns.

Question 10

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.

- 3.15. AAT does not consider that the expanded definitions of matters of material significance adds to the regulatory burden, but is helpful to auditors and independent examiners in deciding what matters need to be reported to the regulator. While the list reflects matters which must be reported, as referred to in 3.1 above, auditors and independent examiners must still exercise subjective judgment on other matters which may require reporting because of their potential material significance, which is determined by what is considered to be such by the stakeholders in the charity (particularly the public at large).

Question 11

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?

3.16. AAT is of the view that it is beneficial to provide as much guidance as possible on the practical aspects of reporting to the regulator including example reports. This should be provided by the regulator on the basis of illustrating what would be helpful to the regulator, and not embodied in auditing standards, so as not to be considered prescriptive or stifle those who may feel it is appropriate to report in some other style or format.

4. About AAT

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and 80,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

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