

Audit of 2018/19 annual report and accounts (CG) - charitable NDPBs

Technical guidance note 2019/1(CG) - module 10



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1 Introduction

Purpose of module

1. This module provides guidance on applying the other modules of technical guidance note 2019/1(CG) to the audit of the statement of accounts of non-departmental public bodies that are registered charities (charitable NDPBs).
2. It also provides supplementary information on, and guidance on the risks of misstatements in, the following areas of a charitable NDPB's statement of accounts:
 - Financial reporting framework (section 2).
 - Fund accounting (section 3).
 - Presentation of financial statements (section 4).
 - Donations and legacies (section 5).
 - Disclosures on trustees' and staff remuneration (section 6).
 - Trustees' annual report (section 7).

Contact point for this module

3. The contact points for this module of the technical guidance note are:
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2 Application of other modules to charitable NDPBs

Summary of other modules' application

4. The following tables summarise the application of the other modules to charitable NDPBs, and either provide supplementary guidance in some areas or indicate the section of this module in which it is provided.

Overview module

5. The following table summarises the application of the overview module which largely applies in full, other than the presentation of financial statements, though there are additional considerations:

Section	Applicability	Supplementary guidance
Section 1 Introduction	Applies	No further guidance required.
Section 2 Financial reporting framework	Applies	The preparation of statement of accounts prepared by registered charities is regulated by the Charities and Trustee Investment (Scotland) Act 2005 (the 2005 Act) and The Charities Accounts (Scotland) Regulations 2006 (the 2006 regulations). The 2006 regulations require the statement of accounts to be prepared in accordance with the methods and principles set out in the Charities SORP (FRS 102) . FReM paragraph 1.4.1 confirms that charitable NDPBs should comply with the 2006 regulations and the relevant charities SORP. FReM paragraph 1.4.3 states that charities should also follow the principles in the FReM and provide the additional disclosures it requires where these go beyond the SORP.
Section 3 Auditing standards	Applies	The Financial Reporting Council's practice note 11 provides guidance on the application of ISAs to charities.

Section	Applicability	Supplementary guidance
Section 5 Presentation of financial statements	Not applicable	Guidance on the presentation of the financial statements is provided at section 4 of this module.
Section 6 Accounting policies, estimates and prior year errors	Applies in principle	The principles apply but auditors should be alert to differences in terminology used by FRS 102.
Section 7 Events after the reporting period	Applies	No further guidance required.

Modules 1 to 8

6. Modules 1 to 8 of the technical guidance note apply in principle to charitable NDPBs but auditors should be alert to slight differences required by FRS 102 or the charities SORP.
7. Supplementary guidance in this module is provided on fund accounting (in section 3) and donations and legacies (in section 5).

Module 9 Non-financial statements

8. FReM paragraph 5.1.8 states that charitable NDPBs are not required to comply with chapter 5 (performance report and accountability report). The following table lists the sections in module 9 which apply to charitable NDPBs along with some supplementary guidance:

Section	Applicability	Supplementary guidance and action
Section 2 Remuneration and staff reports	Not applicable	Guidance on remuneration disclosures is provided at section 6 of this module.
Section 3 Performance report	Not applicable	Guidance on the trustees' annual report is provided at section 7 of this module.
Section 4 Governance statement	Applies	No further guidance is required.
Section 5 Other non-financial statements	Not applicable	Although there is no specific requirement for a charitable NDPB to include a statement of Accountable Officer's responsibilities, they all do in practice.

3 Fund accounting

Summary of financial reporting requirements

9. Module 2 of the SORP sets out the requirements for the analysis and presentation of a charity's funds.

Risks of misstatement

10. The following paragraphs highlight potential risks of misstatement in respect of fund accounting, and set out actions for auditors to undertake to assess whether the charity has followed the required treatment.

Charitable funds are not properly accounted for

11. Fund accounting distinguishes between different classes of fund as set out in the following table:

Class of fund	Explanation
Unrestricted funds	<p>These can be spent or applied at the discretion of the trustees to further any of the charity's purposes. Unrestricted funds can be used to supplement expenditure made from restricted funds.</p> <p>They include funds that the trustees have decided to designate for a particular purpose. This may be because the donor expressed a non-binding preference as to the use of the funds, which falls short of imposing a restriction in trust law.</p>
Restricted income funds	<p>These require to be spent or applied within a reasonable period from their receipt to further a specific purpose of the charity. Restrictions on the use of the funds are generally declared by the donor when making the gift. It is possible that a charity may have several individual restricted funds, each for a particular purpose of the charity.</p>
Permanent endowment funds (also known as capital funds).	<p>An endowment where there is no power to convert the capital into income is known as a permanent endowment fund, which must normally be held indefinitely. Trust law requires a charity to invest the assets of an endowment, or retain them for the charity's use to further its purposes.</p>

12. **Auditors should** assess whether:
- restricted income funds have been spent or applied during 2018/19
 - within a reasonable period from their receipt

- to further one or more (but not all) of the charity's charitable purposes. If the funds can be applied to all the charity's purposes, or the charity only has one purpose, they should be classified as unrestricted.
- each restricted fund, and the income received and expenditure made from it, has been separately identified in the accounting records
- costs charged to a restricted income fund relate to the activities undertaken to further the specific charitable purposes the fund was established to support. These costs include both direct and support costs associated with the activities undertaken by the restricted fund
- expenditure has been charged to a restricted income fund which is in deficit only when there is a realistic expectation that future income will be received to cover the shortfall
- the only expenses charged to permanent endowment funds are those incurred on the administration or protection of the investments or property of the endowment. Where the endowment has insufficient funds to meet the expenses that can be charged to it (or the terms of the trust prohibit the charging of expenses), the expenses have been charged to restricted income funds
- if the trustees exercised the power to spend or apply the capital of an expendable endowment during 2018/19, the relevant funds have become
 - unrestricted funds where the terms of the gift permit expenditure for any of the charity's purposes
 - restricted income funds where the terms permit expenditure only for specific purposes.

Transfers between funds have not been properly accounted for

13. A transfer may be made between funds, for example to transfer assets from unrestricted funds to finance a deficit on a restricted fund or where restricted funds have been lawfully released and transferred to unrestricted funds. **Auditors should** confirm that any transfers during 2018/19 have been presented in the transfer line in the SoFA.

Information on funds has not been properly disclosed

14. [Charities SORP](#) paragraph 2.28 requires a charity to disclose information on: material individual fund balances; movements in the reporting period; and the purposes for which the funds are held. Disclosures should differentiate between unrestricted funds (both general and designated), restricted income funds, permanently endowed funds and expendable endowments. Table 1 in the [charities SORP](#) provides an example of how the movements in material funds may be shown. Further disclosures are required by SORP paragraph 2.29.

Auditors should

- confirm that the trustees have complied with paragraphs 2.28 and 2.29 of the SORP in 2018/19
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

4 Presentation of financial statements

Summary of financial reporting requirements

15. The financial statements for a charitable NDPB are set out in the [charities SORP](#) and the 2006 regulations. The SORP sets out its requirements for the: SoFA at module 4; balance sheet at module 10; and cash flow statement at module 14.

Risks of misstatement

16. The following paragraphs highlight potential risks of misstatement in respect of the presentation of financial statements, and set out actions for auditors to undertake to assess whether the charity has followed the required treatment.

A complete set of financial statements is not properly presented

17. Regulation 8 requires a complete set of financial statements to comprise
- a SoFA which shows the total incoming resources and application of the resources, together with any movements in the total resources, of the charity during 2018/19
 - a balance sheet which shows the state of affairs of the charity as at 31 March 2019
 - a cash flow statement, if appropriate
 - notes to the accounts.
18. **Auditors should** assess whether the charity has
- presented a complete set of financial statements for 2018/19
 - clearly identified the financial statements and distinguished them from the other information in the statement of accounts
 - clearly identified each financial statement and the notes
 - offset assets and liabilities or income and expenses only where required or permitted by the [FRS 102](#) or the [charities SORP](#)
 - presented corresponding amounts in respect of 2017/18 for each item presented
 - adopted the same format for the financial statements as 2017/18, unless there are special reasons for a change that are explained in the notes
 - omitted any line where there is nothing to report in both the current and previous reporting period.

Statement of financial activities is not properly presented

19. The SoFA is a single accounting statement that should include all income, gains, expenditure and losses recognised for 2018/19. The SoFA provides the user with

- an analysis of the income and endowment funds received and the expenditure by the charity on its activities
 - a reconciliation of the movements in a charity's funds for 2018/19.
20. The structure, format and headings of the SoFA are set out in Table 2 of the [charities SORP](#). **Auditors should** confirm that the columns of the SoFA distinguish between restricted income funds, unrestricted funds, and endowment funds
21. If a class of funds is not considered material, it may be combined with another class of funds and shown as a single combined funds column. Where the charity applies this approach, the heading should be changed appropriately (e.g. to 'all unrestricted and restricted funds').

Balance sheet is not properly presented

22. The objective of the balance sheet is to show the resources available to the charity and whether these are available for all purposes of the charity or have to be used for specific purposes because of legal restrictions placed on their use.
23. Table 5 of the [charities SORP](#) sets out the format of a charity's balance sheet and the headings used to present its assets, liabilities and funds. The balance sheet may also be presented in a columnar format that analyses balance sheet items by class of fund.
24. **Auditors should** assess whether
- the balance sheet has been properly presented in accordance with table 5 or in a columnar format
 - where the corresponding amount for 2017/18 is not comparable due to a change in accounting policy, it has been adjusted and the reason for the adjustment explained in the notes to the accounts
 - the balance sheet has been signed by one or more trustees, each of whom has been authorised to do so by the trustee body
 - the balance sheet specifies the date the accounts, including the balance sheet, were approved.

Statement of cash flows is not properly presented

25. The SORP requires the format of the statement of cash flows to follow the requirements of section 7 of FRS 102. The SORP provides a template for the statement of cash flows in table 8.
26. The statement is required to analyse cash flows using three standard headings of operating activities, investing activities and financing activities. The statement should include the movement in cash balances of unrestricted funds and restricted funds including endowment funds.
27. **Auditors should** assess whether the statement of cash flows is presented in accordance with section 7 of FRS 102.

5 Donations and legacies

Summary of financial reporting requirements

28. Module 5 of the [charities SORP](#) sets out the requirements for the recognition of income including legacies. Module 6 covers donated goods and services.
29. Donations and legacies include all income received by the charity that is, in substance, a gift made to it on a voluntary basis. A donation or legacy may be for any purpose of the charity (unrestricted funds) or for a particular purpose of the charity (restricted income funds or endowment funds).

Risks of misstatement

30. The following paragraphs highlight potential risks of misstatement in respect of donations and legacies, and set out actions for auditors to undertake to assess whether the charity has followed the required treatment.

Income from donations is not properly recognised

31. Income from donations should be recognised when the charity becomes entitled to it. Entitlement to a donation usually arises immediately on its receipt, unless there are any terms or conditions which must be met before the charity is entitled to the resources. A condition that simply restricts the use of a donation does not affect a charity's entitlement (although it does affect how the donation is reported in the accounts as explained in section 4).
32. **Auditors should:**
- confirm that donations received during 2018/19 have been recognised as income when there is evidence of entitlement
 - assess whether the amount of income is complete and free from misstatement.

Income from legacies is not properly recognised

33. Legacies should be recognised as income when the three conditions set out in the following table are met:

Condition	Explanation
Evidence of entitlement to the legacy	Entitlement to a legacy cannot arise without the charity knowing of both the existence of a valid will and the death of the benefactor. Evidence of entitlement to a legacy exists when the charity has sufficient evidence that a gift has been left to them and the executor is satisfied that the property in question will not be required to satisfy claims in the estate.

Condition	Explanation
Receipt is probable	<p>Receipt is normally probable when:</p> <ul style="list-style-type: none"> • there has been grant of probate, i.e. authority to the executor of the will to manage the disposal of assets • the executors have established that there are sufficient assets in the estate, after settling any liabilities, to pay the legacy • any conditions attached to the legacy are either within the control of the charity or have been met.
Amount can be measured reliably	In some cases, there may be uncertainty as to the amount of the payment. For example, the legacy may be subject to challenge or the charity's interest may be a residual one.

34. Auditors should:

- confirm that legacies arising during 2018/19 have been recognised as income when the three above conditions have been met
- assess whether the amount of income is complete and free from misstatement
- where there is uncertainty that prevents the amount from being estimated reliably, confirm that the legacy has been disclosed as a contingent asset.

35. Where a payment is received from an estate or is notified as receivable by the executors after 31 March 2019 (and before the accounts are authorised for issue) but it is clear that the payment had been agreed by the executors prior to that date, **auditors should** confirm that it has been treated as an adjusting event and accrued as income if receipt is probable.

Donated facilities and services are not properly accounted for

36. In accordance with SORP paragraph 6.13, facilities and services donated to a charity for its own use which it would otherwise have purchased require to be recognised as income when received.
37. Donated facilities and services should be measured on the basis of the value of the gift to the charity. This is the amount that the charity would pay in the open market for an alternative item that would provide a benefit to the charity equivalent to the donated item. Value to the charity may be lower than, but cannot exceed, the price the charity would pay in the open market for the item.
38. An amount equivalent to the amount recognised as income for donated facilities and services should have been recognised as an expense under the appropriate heading in the SoFA.
39. **Auditors should** confirm that the amount of the facilities and services have been
- recognised in income as a donated service
 - recognised as expenditure
 - disclosed in the notes to the accounts.

Information on donated goods and services is not properly disclosed

40. SORP paragraph 6.31 requires a charity to disclose:

- the accounting policy for the recognition and valuation of donated goods, facilities and services
- the nature and amounts of donated goods, facilities and services receivable from non-exchange transactions recognised in the accounts, for example, seconded staff, use of property, etc.

41. Auditors should:

- confirm that the charity has followed the requirements of SORP paragraph 6.31 in 2018/19
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

6 Disclosure of trustees' and staff remuneration

Summary of financial reporting requirements

42. SORP module 9 sets out disclosure requirements for
 - trustee's remuneration and expenses
 - staff costs and employee benefits.
43. The FReM's requirements for a remuneration and staff report do not apply.

Risks of misstatement

44. The following paragraphs highlight potential risks of misstatement in respect of the disclosure of trustees' and staff remuneration, and set out actions for auditors to undertake to assess whether the charity has followed the required treatment.

Information on trustees' remuneration has not been properly disclosed

45. SORP paragraph 9.6 requires charities to disclose whether the trustees were paid any remuneration or received any other benefits from an employment with their charity or a related entity.
46. **Auditors should** confirm that the charity had disclosed either:
 - a statement that none of the trustees have been paid any relevant remuneration or received any other benefits during 2018/19; or
 - that one or more of the trustees has been paid remuneration or has received other benefits. **Auditors should** confirm that the charity has also disclosed the information set out at SORP paragraph 9.7 and assess whether the disclosure is free from misstatement.

Information on trustee's expenses has not been properly disclosed

47. [Charities SORP](#) paragraph 9.11 requires charities to disclose whether the trustees were reimbursed expenses incurred in carrying out their duties or whether similar payments were made by the charity direct to third parties on their behalf.
48. **Auditors should** confirm that the charity had disclosed either:
 - that no trustee expenses have been incurred; or
 - that one or more of the trustees has claimed expenses or had their expenses met by the charity. Auditors should confirm that the charity has also disclosed the information set out at SORP paragraph 9.12 and assess whether the disclosures are free from misstatement.

Information on staff costs and employee benefits has not been properly disclosed

49. SORP paragraphs 9.26 to 9.30 set out required disclosures in respect of staff costs and employee benefits. Paragraphs 9.31 and 9.32 address the senior management personnel to whom the trustees delegate day-to-day management of the charity's activities (referred to as key management personnel).
50. **Auditors should** confirm that the charity has disclosed:
- details of their total staff costs and employee benefits during 2018/19, analysed in accordance with paragraph 9.26
 - information on any redundancy or termination payments in accordance with paragraph 9.27
 - the average head count (number of staff employed)
 - the number of employees whose total employee benefits (excluding employer pension costs) fell within each band of £10,000 from £60,000 upwards
 - the total amount of any employee benefits received by trustees and its key management personnel for their services to the charity.

7 Trustees' annual report

Summary of financial reporting requirements

51. Module 1 of the [charities SORP](#) sets out the requirements for the trustees' annual report . The required contents are set out at SORP paragraphs 1.14 to 1.53.
52. The FReM requirement for a performance report does not apply to charitable NDPBs.
53. The trustees' annual report is a narrative statement from the trustees which the charity regulations require to be included with the statement of accounts.

Summary of auditors' responsibilities

54. Auditors' responsibilities for a trustees' annual report are the same as for a other central government bodies' performance report (explained in module 9).
55. The test procedures that auditors should undertake to meet the above responsibilities are set out throughout this section and are summarised in Appendix 1.
56. The model independent auditor's report for 2018/19 will be provided in a separate technical guidance note and will include wording for the trustees' annual report opinions .

Risks of misstatement

57. The following paragraphs highlight potential risks of misstatement in the trustees' annual report, and set out actions for auditors to undertake to assess whether the charity has followed the required treatment.

Trustees' annual report is not consistent with the financial statements

58. Auditors must consider whether there are any material inconsistencies in 2018/19 between information in the trustees' annual report and the financial statements, and express an opinion in the independent auditor's report.

Test procedure 1 - inconsistencies with financial statements

Auditors should

- **select amounts or other items in the trustees' annual report and compare them with the corresponding amounts or other items in the financial statements**
- **conclude whether an inconsistency means there is a misstatement**
- **request that any misstatements be corrected**

59. Auditors should refer to section 3 of module 9 for guidance on the above procedures.

Trustees' annual report is not in accordance with applicable requirements

60. Auditors must consider whether the trustees' annual report for 2018/19 has been prepared in accordance with proper accounting practices, and express an opinion in the independent auditor's report.

Test procedure 2 - non-compliance with SORP

Auditors should

- use the checklist at Appendix 2 to assess whether information required by the SORP has been omitted from the trustees' annual report
- request that any misstatements be corrected
- discuss any uncorrected material misstatement in the trustees' annual report with Audit Scotland
- report in the independent auditor's report

61. Auditors should assess whether information required by the charities SORP to be included in the trustees' annual report has been omitted. This includes situations where required information has been presented separately without appropriate cross-reference. In order to assess whether required information has been omitted, auditors should check whether the trustees' annual report includes the items summarised at appendix 3 to this module.
62. If auditors are of the opinion that the trustees' annual report omits a required item, this represents a misstatement. Auditors should request that the body makes the necessary correction.

Trustees' annual report is inconsistent with auditor's knowledge

63. Auditors must consider whether there are any material inconsistencies between information in the trustees' annual report and their knowledge obtained in the audit.

Test procedure 3 - inconsistency with auditor's knowledge

Auditors should

- consider whether there is a material inconsistency between the trustees' annual report and the knowledge they have obtained in performing the audit
- request that any misstatements be corrected

64. Auditors should refer to section 3 of module 9 for guidance on the above procedures.

Information in the trustees' annual report is misleading

65. Auditors must consider whether information in the trustees' annual report is misleading.

Test procedure 4 - misleading information

Auditors should

- **consider whether any information in the trustees' annual report is misleading**
- **request that any misstatements be corrected**
- **discuss any uncorrected material misstatement in the trustees' annual report with Audit Scotland**
- **report in the independent auditor's report**

66. Auditors should refer to section 3 of module 9 for guidance on the above procedures.

Trustees' annual report is not properly signed

67. Auditors should confirm that the trustees' annual report has been signed by one or more of the charity's trustees.

Appendix 1

Auditor action checklist - trustees' annual report

Test procedures	Yes/No/N/A	Initials/date	W/P ref
<p>1 Have you</p> <ul style="list-style-type: none"> selected amounts or other items in the trustees' annual report and compared them with the corresponding amounts or other items in the financial statements? concluded whether an inconsistency with the financial statements means there is a misstatement in the trustees' annual report? requested that any misstatement be corrected? 			
<p>2 Have you</p> <ul style="list-style-type: none"> used the checklist at Appendix 2 to assess whether information required by the applicable requirements has been omitted from the trustees' annual report? requested that any misstatements be corrected? 			
<p>3 Have you</p> <ul style="list-style-type: none"> considered whether there is a material inconsistency between the trustees' annual report and the knowledge you have obtained in performing the audit? requested that any misstatements be corrected? 			
<p>4 Have you</p> <ul style="list-style-type: none"> considered whether any information in the trustees' annual report is misleading? requested that any misstatements be corrected? 			
<p>5 Have you discussed any uncorrected material misstatement in the trustees' annual report with Audit Scotland's Professional Support?</p>			

Appendix 2

Checklist - required content of trustees' annual report

Required item	Yes/No/N/A
1 A summary of the purposes of the charity as set out in its governing document; and the main activities undertaken in relation to those purposes	
2 A summary of the main achievements of the charity	
3 A review of the charity's financial position at the end of the reporting period	
4 Any policy it has for holding reserves, the amounts of those reserves and why they are held. If the trustees have decided that holding reserves is unnecessary, the report must disclose this fact and provide the reasons behind this decision	
5 The identification of any fund that is materially in deficit, with an explanation of the circumstances giving rise to the deficit and the steps being taken to eliminate the deficit	
6 The nature of the governing documents, how the charity is constituted, and the methods used to appoint new trustees	
7 Reference and administrative information including the name of the charity, the names of all those who were the charity's trustees on the date the report was approved or who served as a trustee in the reporting period, and the names of the directors of any corporate trustees on the date the report was approved.	