



## Accounts monitoring review

# Concerns highlighted by auditors in their audit reports

### Summary

In 2017, 80 charities filed accounts with a modified audit opinion, meaning that their accounts are, or may be, materially misstated. This is 17 fewer than in 2016. The main reasons why auditors issued modified audit opinions continued to be inadequate accounting records and not following accounting requirements. The main accounting requirements not met concerned the valuations of properties, investments and recognition of pension liabilities. Most of the charities that submitted accounts with a modified audit opinion in 2016 had addressed their auditor's concerns in their following year's accounts.

It is encouraging that the number of modified audit opinions submitted each year is low compared to the number of charities that are required to have an audit (there are more than 7,000 charities with an income over £1 million). However, trustees should be working with their auditors to ensure that their charity has sound financial systems and accounting records, that its' accounts comply with the SORP and that their auditor has the information needed for their audit.

It remains of particular concern that 32 charities have submitted accounts containing a modified audit opinion in both of the last two years.

### Why are we reviewing auditors' reports?

Audit reports are a useful way of identifying larger charities that may have significant failings in their accounting records or in their compliance with the Statement of Recommended Practice (SORP). Auditors issue a report at the conclusion of their work, stating whether the charity's accounts give a true and fair view of the state of its affairs at the balance sheet date and of its income and expenditure for that year. If the auditor concludes that the accounts are, or may be, materially misstated, then he or she is required to issue what is termed a modified audit opinion.

All charities with an income over £1 million, or with an income over £250,000 and with gross assets over £3.26 million, require an audit of their accounts. Smaller charities may opt for an independent examination of their accounts instead.

### How did we identify auditors' reports with a modified opinion?

We used a text search to identify all the sets of accounts submitted to us in 2017 that contained one of the headings that auditors are required to use when issuing a modified audit opinion: 'qualified opinion', 'adverse opinion' and 'disclaimer of opinion'. Disclaimers of opinion and adverse opinions are the most serious forms of modified opinion in terms of the impact on the accounts of the concerns identified by the auditor.

In 2017, 80 charities submitted at least one set of accounts that contained a modified audit opinion, compared with 97 in 2016. 29 of the charities that submitted accounts in 2016 that contained a modified opinion did so again with their following year's accounts.

The totals are analysed below:

Type of modified opinion/year	2017	2016
Qualified opinion	68	86
Disclaimer of opinion	11	9
Adverse opinion	1	2
<b>Total modified opinions</b>	<b>80</b>	<b>97</b>

The total income reported in 2017, the most recent sets of accounts reviewed, of the charities was £202 million, compared with £195 million in 2016.

## What did we find?

We reviewed the sets of accounts submitted by each of the 80 charities to assess the nature and significance of the concerns that had led the auditor to issue a modified audit opinion.

The charity that received an adverse audit opinion had prepared its accounts on the 'going concern' basis of accounting, but their auditor had concluded that the charity was not a going concern, which raises a serious concern that the charity would be unable to meet its commitments and pay its bills as they fall due and so the accounts are misleading. The main reasons why the other 79 charities received a modified audit opinion could be broadly fall into one of two groups:

- There was insufficient evidence to support figures in their accounts (48 charities, compared with 50 in 2016)
- Their accounts did not comply with the SORP (31 charities, compared with 45 in 2016)

The underlying failings identified were similar to those discussed in our report on the modified opinions submitted in 2016. Most of these fall into one or more of three categories:

- The trustees had not kept adequate records of the charity's transactions and/or assets and liabilities
- The trustees had appointed a new auditor and the auditor had not attended the year end stock count and/or been provided with sufficient evidence to support the previous year's closing balances
- The trustees had not obtained the professional valuations of properties, investments and/or pension liabilities required by the SORP

## What action did we take?

### With the charities that submitted a modified audit opinion

#### **Where a modified opinion was submitted in 2017 (80 charities)**

We considered the issues highlighted in each audit report and any relevant disclosures in the trustees' annual report and accounts to assess whether any regulatory action was required. Where available, we also took into account:

- Any recent engagement with the charity, including where we had provided guidance to the trustees as a result of their having submitted accounts containing a modified audit opinion in 2016
- Any report of a matter of material significance submitted by the auditor
- More recent sets of accounts submitted by the charity

We provided guidance to 18 charities, where we judged that this would help the trustees to address their auditor's concerns. We engaged with a further 4 charities where the auditor's concerns highlighted serious failings of which we were not previously aware and there was no indication that the trustees were taking action to address them.

#### **Where a modified opinion was submitted in 2016 but not in 2017 (68 charities)**

We followed up these charities to establish whether they had addressed the issues raised by their auditor. All except 3 of these charities have submitted their following year's accounts. We found that:

- 58 charities had submitted accounts that contained an 'unqualified' audit or independent examiner's report. This means that the trustees of these charities had sufficiently addressed the issue that had caused the auditor to give a modified opinion on the previous year's accounts. We had either engaged with or provided guidance to the trustees of 27 of these charities in connection with the modified opinion on the previous year's accounts
- 7 charities had submitted accounts that contained either a modified opinion submitted in January 2018 (4 charities) or had a 'qualified' independent examiner's report (3 charities)

Two of the remaining 3 charities are no longer operating. The remaining charity has not yet submitted its following year's accounts.

### With the other UK charity regulators

We have worked with the other UK charity regulators to update the guidance to auditors (and independent examiners) on reporting matters of material significance. The updated guidance, [reporting matters of material significance](#), introduced a requirement for auditors to report to the appropriate regulator as soon as they issue a modified audit opinion. This applies to all opinions issued on or after 1 May 2017. We have published a separate report on how well auditors are complied with this aspect of their reporting responsibilities.

## What are the lessons for other charities?

If a charity's auditor issues a modified audit opinion on the charity's accounts, this may damage supporters' and funders' confidence in the trustees' governance of that charity. Where appropriate, the trustees' annual report should explain the circumstances behind a modified audit opinion and

provide assurance that the trustees are taking action in response to the concerns reported by their auditor.

To minimise the risk of a modified audit opinion, trustees need to check that their charity has sound financial systems and accounting records in place, take SORP compliance seriously and work with their auditors to provide the information that they will need for their audit. We have produced a range of guidance to help trustees. [Internal financial controls for charities \(CC8\)](#) and [Charity reporting and accounting: the essentials November 2016 \(CC15d\)](#) are good starting points for the issues identified in this review.

The current version of the SORP can be found on the dedicated [SORP website](#), which also includes help-sheets and worked examples.

## About our accounts monitoring reports

Charities' accounts are publicly available on our online search tool [Find charities](#)

In addition to reviewing sets of accounts with modified audit opinions, we also monitor a sample of accounts to check for accounts quality and the reporting of public benefit. The outcome of our accounts monitoring activity is a series of reports on our findings to help trustees manage the risks that their charity faces, improve reporting standards and enhance the accountability of charities to their donors, beneficiaries and the public.