



**Ministry of Business,
Innovation & Employment**

Auditing and Assurance for Large & Medium Registered Charities – Concrete Proposals

**Report summarising public submissions on
the February 2013 discussion paper**

May 2013



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1. Introduction

- 1.1. In April 2012, the Ministry of Business, Innovation and Employment (MBIE) sought submissions on its 'Auditing and Assurance for Larger Registered Charities' Discussion. That paper, which tentatively proposed mandatory assurance for registered charities with annual operating expenditure of \$200,000 or more, resulted in 60 submissions from a range of stakeholders.
- 1.2. Following that process, MBIE released a second discussion document entitled 'Auditing and Assurance for Large and Medium Registered Charities – Concrete Proposals'. The purpose of the second discussion document was to outline concrete proposals taking formal submissions and other information obtained from stakeholders into consideration.
- 1.3. The revised proposals are:
 - To require large registered charities to have their financial statements audited. A charity will be large if its operating expenditure (OPEX) was \$1 million or more for both of the last two financial years.
 - To require medium sized charities to have their financial statements reviewed or audited. A charity will be medium sized if it is not large and its OPEX was \$400,000 or more for both of the last two financial years.
 - To only permit audits and reviews to be carried out by persons and firms meeting the qualification requirements in clauses 34-36 of the Financial Reporting Bill that is currently before Parliament.
 - The Department of Internal Affairs would, on a risk basis, monitor compliance with accounting standards that will apply to registered charities from 2015 onwards.
- 1.4. This report provides a summary of the key themes in the public submissions on the discussion paper. **Table 1** below sets out the number of submissions received by category of submitter. A copy of each individual submission is available at: <http://www.med.govt.nz/business/business-law/financial-reporting-framework-review>

Category	Submission	Percentage
Accounting Practices	9	33%
Registered Charities	8	30%
Individuals	3	11%
Universities/ Academics	1	4%
Iwi group	2	7%
Professional Bodies	4	15%
Total	27	100%

Table 1 – Submissions by Category

2. Summary of Responses to Discussion Paper Questions

Audit Requirement

Discussion paper question 1.A: What are your views on an audit requirement for large registered charities?

- 2.1 All responses to this question were in support of an audit requirement for large registered charities. Respondents noted that an audit requirement was necessary for large registered charities in order to ensure transparency and accountability and thereby maintain public confidence in the charity sector, and considered that an audit is an important check given that charitable entities enjoy exemption from income tax.
- 2.2 Submissions also noted that while compliance costs may be increased for some charities due to this legislation, the status quo of potentially poor quality financial information leads to suboptimal decision-making. Without reliable comparable financial information, respondents considered that the general public will be unable to assess the performance and financial health of charities and be able to make informed decisions as to their donations.
- 2.3 Other submissions noted that an audit provides a broader range of benefits than financial assurance, including as a measure to assess the effectiveness of financial systems and procedures, and the improvement of governance over some aspects of the charity's operations as well as reducing the risk of fraud.
- 2.4 One respondent, a large accounting firm, strongly advocated that the proposals surrounding mandatory audit or review requirements specifically require that the audit or review of a charity's financial statements be performed in accordance with the applicable standards for audits or reviews of financial statements issued by the External Reporting Board (XRB). That submission noted the importance of ensuring that the audit or review is carried out by a qualified accountant on a consistent and comparable basis, and to support the quality performance of the audit or review engagement.

Audit or Review Requirement

Discussion paper question 1.B: What are your views on a review or audit requirement for medium registered charities?

- 2.5 Respondents were in support of a review or audit requirement for medium registered charities. However some respondents qualified their support by noting that public awareness around the different types of assurance available, and particularly what a review engagement involves, needs to be increased.
- 2.6 By increasing public awareness of the different types of assurance available to charities, respondents noted that the users of financial information would be able to make better informed choices based on a cost-benefit analysis of the expense of an audit or review against the incremental benefit to the charity and the users of the charity's financial statements.

2.7 As stated in paragraph 2.4 above, one respondent again advocated that the proposals be performed in accordance with the applicable standards for reviews and audits issued by the XRB, as this is important to ensure that audits and reviews are carried out on a consistent and comparable basis.

Measure for Thresholds

Discussion paper question 1.C: What are your views on the use of annual operating expenditure (OPEX) to determine whether a charity is medium or large?

2.8 All respondents were in support of the use of OPEX as a determinant for whether a charity meets the medium or large thresholds. Many respondents noted the need for consistency in the assessment of financial information and agreed that OPEX provides the most consistently reliable measure.

2.9 Several respondents qualified their support for OPEX as a measure for determining whether a charity is medium or large by submitting that OPEX should specifically exclude the purchase of goods for resale. These respondents noted that there are numerous entities that are trading charities, which raise funds for their charitable purposes by running a business rather than seeking grants and donations and thereby have lower levels of public accountability than other charities. The costs of running such charities are similar to other charities, but they have the extra operating costs associated with running the business, therefore trading costs should be excluded.

2.10 The New Zealand Institute of Chartered Accountants (NZICA) noted that the use of OPEX as a measure is open to manipulation by the netting down of expenditure with income, particularly within the volunteering context. NZICA also submits that more consideration should be given to removing grants from the size criteria of charities, given that a grant-making registered charity with relatively small administrative expenses is unlikely to be considered economically significant if it is primarily acting as an intermediary to allocate funds for the public benefit.

2.11 While the New Zealand Law Society was in support of the use of OPEX as a determining measure, it noted that some members of the accounting profession are concerned about the inconsistent application under the proposal with the criteria being applied by the XRB for public benefit entities, and urged the need for a rationalisation of the applicable thresholds.

Proposed Thresholds

Discussion paper question 1.D: What are your views on the threshold for large registered charities being set at OPEX of \$1 million or more a year for a two consecutive year period?

2.12 There were mixed responses to this question. The majority of respondents agreed that the threshold for large registered charities should be set at an OPEX of \$1 million or more a year for two consecutive years.



- 2.13 Two respondents considered that \$2 million OPEX is a more appropriate threshold for large registered charities, given the \$2 million threshold applicable under the XRB accounting standards framework.
- 2.14 The Inter Church Working Party submitted that \$1.5 million OPEX is a more appropriate threshold. That respondent reasoned that many charities receive a significant part of their income by way of voluntary donations, thereby making it difficult for an auditor to properly complete an audit because there is no regular pattern to the donations. The implication was that by setting the threshold 50% higher, many of the smaller churches would not be caught by the proposed mandatory audit requirement.
- 2.15 Another respondent expressed concern at the variance between the thresholds proposed in New Zealand and those set in Australia. It noted that while the system in Australia adopts operating revenue as a measure as opposed to OPEX, the relative proportion of charities caught by the 'large' and 'medium' thresholds in Australia is significantly higher than in New Zealand. It therefore proposed that the variance needs to be carefully considered and reconciled by setting the New Zealand thresholds at a starting point more in line with the Australian levels.

Discussion paper question 1.E: What are your views on the threshold for medium registered charities being set at OPEX of between \$400,000 and \$1 million a year for a two consecutive year period?

- 2.16 Views were divergent on this question. The respondents that agreed that the threshold should be set at \$400,000 OPEX, believed that it is valuable given that this is a broader range that initially proposed. While over 40% of the responses disagreed that the threshold for medium sized charities should be set at \$400,000 OPEX.
- 2.17 Of those respondents that disagreed, some considered that the threshold should be reduced to \$250,000 in order to bring the proportion of charities subject to mandatory assurance requirements in New Zealand in line with Australian levels. They noted that New Zealand should aim to have 22% of registered charities undertaking some form of mandatory assurance.
- 2.18 Other respondents submitted that a higher threshold for 'medium' registered charities should be adopted, with three respondents advocating for the threshold to be increased to between \$500,000 and \$600,000 OPEX. In line with the arguments raised in paragraph 2.9 above, some respondents submitted that the increased threshold of \$500,000 OPEX should specifically exclude the purchase of goods for resale. Another respondent considered that a threshold of \$500,000 OPEX would be more appropriate in that the cost/benefit analysis of a review engagement would become more viable in respect of what the users of that financial information would gain.

Two Consecutive Year Test

Discussion paper question 1.F: What are your views on the two consecutive year test?

- 2.19 The majority of submissions were in support of this question. Some respondents noted that this approach allows for year to year variations, thereby enhancing stability and that it is consistent with



the approach adopted in the XRB revised accounting standards tier setting criteria and will therefore be familiar in New Zealand.

- 2.20 Other respondents expressed confusion as to what occurs when an entity falls below a level, and suggested that a one year test should be applied if an entity goes down and wishes to opt for a lower form of assurance or none if they fall below \$400,000 annual OPEX.
- 2.21 In a similar vein, NZICA suggested that further consideration and clarity is required in determining the switching characteristics between an audit and a review. It provides the example that a registered charity with OPEX of \$900,000 may elect to be reviewed, and if in the following year its OPEX exceeds \$1 million, it may continue to be reviewed as it has not exceeded the threshold over two consecutive years. While it is clear that if in the third year its OPEX is still above \$1 million an audit would be required, it is unclear to the respondent whether the second year would subsequently require an audit on the basis that XRB accounting standards state financial statements must include comparatives. It is submitted that further explanation on this issue would be beneficial.
- 2.22 The Inter Church Working Party agreed with the two year test but submitted that it should only apply after OPEX has exceeded the threshold for two complete consecutive years. That is to say, in the third year.
- 2.23 Another charity disagreed with the two-year test, suggesting instead that a three year test would be more appropriate. The respondent reasoned that charities established for a single project, or who undertake a specific project over and above its core base activities, and this project crosses over two financial years, will find themselves subject to disclosure requirements that would be inappropriate for that charity and would not add additional benefit.

Mechanism to Increase Thresholds

Discussion paper question 1.G: What are your views on a regulation-making power to change the dollar amounts in line with changes in the consumer price index, no less than every 8 years?

- 2.24 All respondents agreed with the need to have a mechanism to review the thresholds, however there was some disagreement as to the period for review. Most respondents agreed with the period for review being set at a rate consistent with the XRB accounting standards levels.
- 2.25 Some respondents considered that the review period should be set more frequently than every 8 years. One such respondent submitted that the thresholds should be considered on a two yearly basis in line with the two-year test outlined in question 1.F, and that costs associated with review can be reduced by making the threshold automatically rise to the CPI over the two-years and allow for a full review every 8 years. Other respondents suggested that the review should be set at a maximum of every 5 years as this would mean the timing of review of dollar amounts would be more in line with the normal cycle of business.



- 2.26 One respondent agreed with the proposition but considered that the new dollar amount of the threshold should take into account more than the changes to the CPI and be undertaken every three to five years. In times of low inflation, that respondent submitted that eight years may be adequate but in times of moderate or high inflation, three years would be a more appropriate time frame.
- 2.27 CPA Australia supported a mechanism to monitor the monetary thresholds of the different tiers and revise it periodically, as required. However, they were of the opinion that a timeframe compelling their revision is not necessary. They suggested that the monitoring process should be sufficiently robust to ensure any significant events that may affect the monetary thresholds are identified and signalled to the decision makers when they arise.

Non-Assurance Engagements

Discussion paper question 1.H: What are your views on no non-assurance engagement requirements for any class of registered charity?

- 2.28 The responses to this question were generally in agreement that there should not be a legislative requirement to have a non-assurance engagement completed. Some respondents commented that such non-assurance engagements should be made by the charities themselves.
- 2.29 Other respondents considered that optional non-assurance mechanisms should be included in the suite of tools used by all charities, as there is considerable benefit in the reporting quality that may be derived from compilation services when conducted by a chartered accountant using the applicable financial reporting framework. They noted that the compilation engagement is a particularly relevant service for charitable entities that do not have adequate internal capacity to competently prepare financial statements in accordance with the applicable financial reporting framework.
- 2.30 One respondent who disagreed with the proposal not to have non-assurance engagement requirements for charities submitted that various alternatives to a full financial audit or review need to be considered. The respondent noted that many charities are expecting subsidised audit services from auditors at rates of 50% to 60% below their time costs, and that this is unacceptable from an auditor's point of view going forward. The respondent submitted that alternatives could include a compilation engagement, limited reviews or partial reasonable assurance under a compliance audit engagement.

No Exemptions

Discussion paper question 1.I: What are your views on no exemption making powers?

- 2.31 Responses to this question were varied. A majority of respondents agreed that as all registered charities are publically accountable due to their exemption from income tax, there should be no exemption making powers.
- 2.32 However a small number of respondents considered that charities that are wholly privately funded should be able to be exempt from public disclosure of their financial statements if their donors wish to



remain anonymous. Such charities would remain under an obligation to have their assurance engagements completed, but it is submitted they would only be required to report to the DIA Registrar of Charities and Inland Revenue, and should have the option of being exempt from the requirement that their assured financial statements be publically disclosed. They noted that some donors wish to perform their philanthropy privately and public disclosure may discourage their philanthropic activities.

- 2.33 Other respondents submitted that there should be an exemption for consolidated groups, in line with the financial reporting approvals under the group registration provisions of the Charities Act 2005. That is, where a medium or large charity is approved by the former Charities Commission under section 46 of the Charities Act to submit consolidated accounts, auditing and assurance requirements should apply to those consolidated accounts only and each subsidiary charity should not be made to comply with the proposed audit and assurance procedures, other than as within the consolidated group.

Assurer's Qualifications

Discussion paper question 1.J: What are your views on limiting assurance engagements to qualified accountants?

- 2.34 Responses to this question were consistently in favour of limiting assurance engagements to qualified accountants. Many respondents commented that without such a quality benchmark, the public benefit is unlikely to be served as charities may be relying on substandard assurance statements and the purpose of giving the end user some degree of assurance would be undermined by an inconsistency in the quality of audit or review engagements.
- 2.35 A number of respondents, however, expressed concerns that restricting the persons who can carry out assurance engagements to qualified accountants would result in an inappropriate pool of qualified accountants available to serve the assurance and audit needs of all relevant stakeholders in New Zealand, particularly in rural areas. The Inter Church Working Party noted that the restriction will also have a detrimental effect in that the cost of compliance will increase and the time required to complete assurance engagements will increase each year due to the reduced number of people available to complete the work. Another respondent considered that for the additional costs associated with becoming a licenced auditor will for some accounting firms exceed the income they can expect from the business from charities, such that those firms will not undertake audits for charities.
- 2.36 To this end, the Inter Church Working Party suggested that the pool of people should include any member of NZICA who is able to undertake audits or reviews in compliance with the relevant standards. Further, they submitted that chartered accountants with "retired" status should be permitted to undertake reviews for medium sized charities.
- 2.37 Pricewaterhouse Coopers submitted that MBIE and DIA need to ensure that there is an adequate supply of quality providers of assurance and related services. In this regard, they suggested a need for a system of licencing of approved auditors to supplement the "licenced auditor" regime applicable to issuers, and encourage MBIE and the Charities Commission to engage with registered professional accounting bodies on the quality standards to be applied for non-FMA licenced auditors.

2.38 Other respondents suggested that the restrictions need to be extended. One respondent recommended that MBIE explore an extension to the qualification to all registered charities, including those with less than OPEX \$400,000 but who still have their statements audited, reviewed or compiled. Another respondent submitted that ordinarily qualified accountants do not provide a high enough standard of assurance and that additional qualifications are necessary. The respondent proposed that the following requirements must be met by the persons undertaking an assurance engagement:

- An accounting degree or NZICA membership; and
- A qualification or experience in the not-for-profit sector; and
- Either current involvement in not-for-profit management or the ability to demonstrate a not-for-profit focus in continued professional development.

Monitoring of Compliance

Discussion paper question 1.K: What are your views on the monitoring of compliance with applicable standards by the Department of Internal Affairs?

2.39 The majority of responses were in favour of the monitoring of charities' compliance with the applicable accounting standards by the Department of Internal Affairs. Some respondents commented that without some monitoring of compliance for those who are not completing an assurance engagement, there will be uncertainty as to whether accounting standards are being applied to a large percentage of the sector.

2.40 While essentially agreeing with the monitoring proposal, many respondents expressed concern at the likely prospect of increased levies to charitable entities in order to fund the monitoring. In this regard, some respondents welcomed a review of the levies as small charities would otherwise carry a disproportionate financial burden for monitoring. Another respondent submitted that rather than increasing levies, resourcing of the proposed monitoring could be effected through a re-assessment of the current Charity Services budget. If levies are to be increased, respondents submitted that the increase should be moderate, equitable and not burdensome. Others also questioned whether the constitutions of charities would fall within the scope of compliance monitoring.

2.41 Another respondent considered that aligning auditing, assurance and reporting requirements across government agencies would avoid duplication and could reduce the need for DIA monitoring where organisations are already required by regulation or legislation to adhere to accounting requirements and already monitored through other systems such as licencing and funding processes.

2.42 The Inter Church Working Party was not in support of the proposal to have the DIA monitor compliance with applicable accounting standards, as this would increase compliance costs for registered charities. They submitted that where the reports have been completed by a qualified auditor, there is no need for further monitoring by the DIA. Rather, the auditor or reviewer should be required to state in his or her report that the accounts have been prepared in accordance with the

relevant XRB standards. The respondent suggested that, unless a complaint is laid against a charity, no further investigation should be required.

Further Comments

Discussion paper question 2: Do you have any other comments?

- 2.43 There were few further comments from respondents. Some respondents noted the need for further on going education to ensure that the governing bodies of charities understand the conditions for undertaking either a review or an audit of financial information.
- 2.44 In reference to the *Concrete Proposals* discussion paper, NZICA notes that an audit provides a "reasonable" level of assurance, as opposed to a "high" level. NZICA also notes that paragraph 24 of the discussion paper gives the impression that auditors are performing work on internal controls to a greater extent than reality.
- 2.45 Another respondent expressed concern that only medium and large charities are being focussed on. In particular, that respondent was concerned at not having any auditing standards, even voluntary, for small charities with OPEX under \$400,000. They submitted that this will result in inconsistency in auditing among small charities, with levels of auditing determined by their constitutions or by the demands of their funders. The respondent submits that a voluntary standard be initiated for small charities and not-for-profit organisations.



3. Conclusions

- 3.1 This consultation process was helpful in further ascertaining stakeholders' views on auditing and assurance requirements for large and medium registered charities. There was broad consensus on the need for compulsory assurance for large and medium registered charities, and all respondents were in support of OPEX as the measure for ascertaining the thresholds for such charities. There was also broad support for limiting assurance engagements to qualified accountants and for the monitoring of compliance with applicable accounting standards by the Department of Internal Affairs.
- 3.2 Most respondents agreed that the threshold for 'large' registered charities should be set at \$1 million OPEX over two-consecutive years, while a small number of respondents advocated that the threshold be increased to \$2 million in order to bring it in line with the threshold set under the XRB accounting standards framework.
- 3.3 Where there was a wider divergence of views was in relation to the \$400,000 OPEX threshold for 'medium' registered charities. While a majority still agreed that the threshold should be set at \$400,000 OPEX, some respondents submitted that the threshold should be reduced to \$250,000 OPEX in order to bring the proportion of charities under assurance requirements in New Zealand more in line with Australian levels. Other respondents advocated for the threshold to be increased to between \$500,000 and \$600,000 OPEX in order to make the cost benefit rationale of a review more viable in terms of what end users would gain. Given this variability in responses, the proposed threshold of \$400,000 OPEX finds an appropriate equilibrium and is therefore supported by MBIE as the most suitable threshold for "medium" registered charities.
- 3.4 General consensus was also reached on the two consecutive year test and on the requirement for a mechanism to review the thresholds. However there were mixed views on the period of review, with several respondents noting that the period should be more frequent than every 8 years.
- 3.5 Most respondents were in agreement that there should be no legislative requirement to have non-assurance engagements completed and that there should be no exemption making powers. Although a small number of respondents considered that charities which are wholly privately funded should have the option of being exempt from the requirement that their assured financial statements be publically disclosed.



Annex 1 – Profiling of Answers based on Entity Groupings

Questions	Accountants		Charities		Individuals		Iwi Groups		Professional Bodies		Academics		Totals	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
1.A	4	0	1	0	1	0	1	0	3	0	1	0	10	0
1.B	5	0	5	0	1	0	1	0	3	0	1	0	16	0
1.C	6	0	4	0	3	0	1	0	3	0	1	0	18	0
1.D	4	0	2	3	1	0	1	0	2	0	1	0	11	3
1.E	3	4	3	1	0	1	1	1	2	0	1	0	10	7
1.F	4	0	3	1	1	0	1	0	3	0	2	0	14	1
1.G	2	2	4	0	1	0	1	0	3	1	1	0	12	3
1.H	3	1	3	1	1	0	1	0	1	1	1	0	10	3
1.I	2	2	3	1	0	1	1	1	3	0	1	0	10	5
1.J	5	1	4	1	1	0	1	0	4	0	1	0	16	2
1.K	2	1	4	1	1	0	1	0	3	0	1	0	12	2



Annex 2 – List of Respondents

1. Accounting for Charities Trust
2. Adam Yates
3. ANGOA
4. CCS Disability Action
5. Christchurch Community Accounting
6. CPA Australia
7. Dave Henderson (Coordinator of ANGOA)
8. Diana Zadravec
9. Diane Robinson
10. Ernest R Yeoman
11. External Reporting Board
12. Glenn Sullivan
13. Hayes Knight
14. Inter Church Working Party
15. James Hill
16. Lloyd Brewerton
17. Massey University
18. New Zealand Institute of Chartered Accountants
19. New Zealand Kindergartens Inc.
20. New Zealand Law Society
21. Pregnancy Help Inc.
22. PricewaterhouseCoopers (PwC)
23. Social Development Partners
24. Te Runanga o Ngai Tahu
25. Te Taiwhenua o Heretaunga
26. The Order of St John
27. Thompson, Lang & Associates