



**Ministry of Business,  
Innovation & Employment**

# **Auditing and Assurance for Larger Registered Charities**

**Report summarising public submissions  
on the April 2012 discussion paper**

August 2012



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## 1. Introduction

- 1.1. The Ministry of Business, Innovation and Employment (MBIE) sought submissions on its 'Auditing and Assurance for Larger Registered Charities' Discussion Paper (the discussion paper) from April 2012 to 20 July 2012. The purpose of the consultation process was to obtain information that will contribute to the Minister of Commerce providing advice to Cabinet on the possible need for audit and assurance of financial statements prepared by larger registered charities.
- 1.2. Charity regulation aims to promote public confidence and trust in fundraising through increasing the accountability and transparency of registered charities, thereby increasing the public's willingness to donate. With this aim, the current situation requires registered charities to disclose certain information to the public via the Charities Register. These requirements include attaching financial statements to the annual report that charities lodge with the Charities Board as a condition of retaining registration and the associated tax benefits. However, as there is no audit or assurance requirement at present – there is no measure to assess the reliability of the financial information lodged. Further, recent studies demonstrate that the quality of financial information currently lodged is of a generally low standard<sup>1</sup>.
- 1.3. The main objective of the discussion paper was to find an appropriate balance between the benefits to be gained from assurance in relation to increased quality and reliability of financial statements and the additional costs associated with having the assurance engagement completed. The discussion paper tentatively proposed the following requirements in relation to charities that are not subject to the Public Audit Act 2001:
  - Registered charities with annual operating expenditure of \$200,000 or more would be required to have an audit or review engagement completed;
  - Registered charities with annual operating expenditure of \$300,000 or more would be required to have an audit completed.
- 1.4. The discussion paper also sought stakeholders' views on related issues, including the minimum qualifications for auditors. 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	Submissions	Percentage
Accounting practices	25	42%
Registered Charities	29	48%
Individuals	4	7%
Universities/Academics	2	3%
<b>Total</b>	<b>60</b>	<b>100%</b>

**Table 1 – Submissions by category**

<sup>1</sup> Cordery, Dr Carolyn & Kapil Patel, *Financial Reporting Stocktake: An Assessment of Accountability through Charities' Filing on New Zealand's Charities Register*, 18 March 2011; and Sinclair, Rowena, *Understandability and Transparency of the Financial Statements of Charities*, PhD thesis submitted to Auckland University of Technology, 2010.



## 2. Analysis of Key Themes

- 2.1 A more detailed analysis of the responses to individual discussion questions is set out in the sections that follow. However, a number of key themes emerged from the responses to the discussion paper which are summarised here.
- 2.2 Most respondents acknowledged the importance of public confidence to the maintenance and growth of the charitable sector, while noting also the crucial need to ensure that the benefits assurance provides for public confidence in the sector do not outweigh the financial costs of undertaking an assurance engagement.
- 2.3 Many respondents, from across all stakeholder categories, expressed concern that the proposed compliance requirements apply to all 'larger' registered charities, including charities that do not receive funds from the public. This raised questions about the public accountability benefits of the proposals for private charities. Some respondents also raised concerns that the proposed assurance engagements would provide little benefit to the donating public and funders in relation to verifying whether charitable funds are being used for their intended purposes.
- 2.4 A large proportion of respondents, particularly charities, expressed a preference for non-assurance models, such as charity-sector standards for financial statements, increased education and a penalty scheme for those charities that consistently produce inaccurate financial information. Some respondents also noted that the current principles of generally accepted accounting practice (GAAP) are not necessarily the most compatible with the not-for-profit (NFP) business model.
- 2.5 A high proportion of the respondents from registered charities were concerned about the relative scarcity of qualified auditors, particularly in rural areas – and noted that the availability of these auditors is likely to decrease in the event of mandatory assurance compliance.
- 2.6 The cost of assurance was also a consistently described tension across all stakeholder groups, with the majority of submissions suggesting that the figures provided in the discussion paper did not reflect the costs in their experience and would be likely to increase in the event of mandatory compliance.



### 3. Summary of Responses to Discussion Paper Questions

#### Problem Definition

*Discussion paper question 1: Do you have any comments on the description of the problem definition?*

- 3.1 The problem outlined in paragraph 16 of the discussion paper is that many charities produce financial statements that currently do not comply with GAAP. This results in a lack of transparency, accountability, comparability and reliability of financial statements prepared on behalf of registered charities. The discussion paper refers to the research of Dr Rowena Sinclair, which cites several examples of practices that are fundamentally inconsistent with GAAP. Her research also notes examples of some charities actively lowering their assets or income to appear poorer in order to attract funding. The discussion paper advocated that assurance would help to address issues with poor quality financial reporting.
- 3.2 Nearly all responses to this question supported and welcomed the need for improved financial reporting by charities. However, there was little consensus on whether assurance was the best method of achieving this. Of the respondents that commented on this question, 15 were in agreement with the problem definition and 18 were in disagreement.
- 3.3 The submissions in agreement with the problem definition, which included several accountants and charities, noted that the current variances in reporting standards among registered charities could be adequately addressed by the proposal for mandatory assurance for all larger registered charities.
- 3.4 Many of the submissions agreed that the lack of comparability and reliability of financial statements of charities was problematic. However, not all submitters were in agreement that mandatory assurance was the best approach to address the problem. A recurring comment was that the introduction of an improved set of accounting standards for charities would be a preferable approach. In particular, given that the New Zealand External Reporting Board (XRB) has recently undertaken to implement financial reporting standards for NFP entities where annual expenses are less than \$2 million some respondents were concerned that the potential of these standards to address the problem was not raised in the discussion paper.
- 3.5 Several submitted commented on issues with quality that they had experienced with employing accountants to prepare their financial statements. A couple of submitters noted that it is the responsibility of the governance board of a charity to ensure that the financial statements prepared by an accountant on their behalf are of an acceptable standard, because it is the governance body that is responsible for submitting the financial statement to the Charities Board as per the registration requirements.
- 3.6 Some accountants considered that the problem definition was based on insufficient research and inaccurate generalisations, making it difficult to evaluate its credibility. Submissions noted that the definition was heavily reliant on the research of Dr Sinclair, which reviewed only a limited range of registered charities and made statements based on several examples. Having questioned the prudence of basing the definition on one piece of research, some accountants' submissions called for a more robust study into current financial reporting for registered charities.



- 3.7 Another concern among certain respondents was the description of the problem being “widespread non-compliance with GAAP by registered charities.” It was raised that certain GAAP compliant practices are not wholly compatible with activities of NFP entities. For example, Dr Sinclair cited “not including donated assets” as an example of non-GAAP compliant practices. However, the XRB has indicated in its simple format reporting (SFR) for NFP entities that “the costs of reporting such items as income are unlikely to outweigh the benefits...”. It was suggested that this indicates that the treatment of not including donated assets in the balance sheet is not fundamentally inconsistent with GAAP. Another charitable activity that was noted to sit awkwardly with GAAP is the employment of volunteers. It was submitted that more consideration needs to be given to how such activities would be treated under the proposed framework.
- 3.8 Charities expressed concern that the proposals included all larger registered charities, rather than being limited to those charities that undertake public fundraising. They accepted that the advantage of assurance is to provide the donating public and other interested third parties with financial statements that are more reliable and comparable. However, some submissions noted that this advantage does not extend to privately-funded charities that do not seek public donations, and therefore that the costs of engaging in assurance for these types of charities outweighs the benefits.
- 3.9 One submission observed that the discussion paper did not refer to the recommendation made by the XRB working group that charitable entities that undertake public fundraising should be required to have a note to the financial statements that identifies net fundraising proceeds. Given that assurance cannot provide information on whether charitable proceeds were spent according to their intended purpose, it was submitted that this would be a valuable step towards reaching the aims of transparency and public confidence in the sector.

### **Objective**

*Discussion paper question 2: Do you have any comments on the description of the objective?*

- 3.10 The discussion paper outlines the objectives of charity regulation as follows:
- To promote public trust and confidence in the charity sector;
  - To help potential funders and donors make informed decisions about the charities they will support; and
  - To promote charities’ accountability to the public by providing information about whether funds or other assets they have obtained from the public are being used effectively and efficiently.
- 3.11 The primary objective of the discussion paper was to find an appropriate balance between the benefits to be gained from assurance in relation to increased quality and reliability of financial statements and the additional costs associated with having the assurance engagement completed.



- 3.12 All submissions were in agreement with the tenor of the objectives of charity regulation and a slim majority of the submissions were in agreement with the objective of the discussion paper. Those that agreed with the objective in the discussion paper welcomed the introduction of minimum standards for large charities and fully supported integrity of financial reporting and the promotion of public confidence in the charitable sector.
- 3.13 Of those that disagreed, some accounting respondents noted that considering ways of improving financial statements – and in particular whether the benefits of assurance would outweigh the associated costs – is secondary to the objectives listed in paragraph 3.10. In this regard, they raised suggestions that a range of measures may be required. Some submissions noted that the effect of the introduction of the XRB's proposed accounting standards could also be said to increase the quality and reliability of financial statements, albeit at a lesser cost than assurance. One respondent also questioned how the new standard would be expected to combine with the assurance requirement to solve the problem. Further commentary on other options is summarised under the following discussion paper question.

### **Options**

*Discussion paper question 3: Do you have any comments on the description of the options?*

- 3.14 The discussion paper notes in paragraph 21 that the main options are whether larger charities should be required by legislation to have an assurance engagement completed, and – if so – whether there should be a tiered approach to assurance. It is set out in the subsequent paragraph that the two internationally-recognised types of assurance engagement are an audit and a review.
- 3.15 There was a wide variation in responses to this question. The majority of responses from charities were in support of the tiered approach based on the audit and review methods of assurance engagement. The majority of accountants' responses – while in favour of a tiered approach – made suggestions for further options not stated in the discussion paper. There were several commonalities in the suggested options, and these are discussed below.
- 3.16 Many of the respondents from across all stakeholder categories supported including the option of a review engagement. Several of those who were in support of the two options (review and audit), noted that the provision of further information about the differences between an audit and a review would be beneficial for the sector. They noted that it is not well understood that a review is available as an alternative form of assurance and that there are varying degrees of quality in the reviews carried out. It was suggested that both accountants and NFPs could benefit from non-statutory guidance, such as a set of straight-forward guidelines, in order for users to make more informed choices as to the most suitable option.



- 3.17 The New Zealand Institute of Chartered Accountants (NZICA) and the Office of the Auditor-General (OAG) noted that the Statement of Review Engagement Standards is dated and that a new standard on reviews is about to be released by the International Auditing and Assurance Standards Board (IAASB). This standard, which will become the applicable standard for review engagements in New Zealand, is more comprehensive than the existing standard<sup>2</sup>. It was therefore suggested that the new IAASB standard should form part of the changes to the reporting frameworks.
- 3.18 Accountants largely agreed that while the options in the paper are reasonable, other alternative forms of engagement could have been explored. One option raised was for a compilation engagement to be performed by a Chartered Accountant. The objective of a compilation engagement is to compile unaudited financial information into financial statement format based on information provided by the client. Although no assurance is provided under a compilation engagement, it does serve the purpose of ensuring that a registered charity's financial statements are in compliance with GAAP. Among some of the larger accounting respondents, it was noted that a compilation engagement is widely recognised as a suitable service for smaller entities which can derive comfort from the fact that a Chartered Accountant has compiled their financial statements following robust professional standards<sup>3</sup>.
- 3.19 Another alternative to a review that was suggested was an Agreed Upon Procedures engagement. Although not expressing a positive or negative assurance, this engagement requires the Chartered Accountant to report factual findings in response to set procedures. In particular, this type of engagement would report on whether public or government grants have been correctly spent and managed by the charities in accordance with funding conditions. There are set standards and associated guidelines published by NZICA which would govern the scope and level of reporting required by an Agreed Upon Procedures engagement.
- 3.20 NZICA and other respondents also raised the option of a compliance engagement, conducted under SAE 3100 and ISAE (NZ) 3000. This type of engagement would address whether the entity exists, whether it is financially viable and whether funds received have been expensed for the purpose for which they were granted.
- 3.21 Several respondents also raised concerns as to how the new proposal would be enforced, and whether a penalty regime would apply.

### **Mandatory Assurance**

*Discussion paper question 4: Do you consider that large charities should be required by legislation to have an assurance engagement completed?*

- 3.22 The responses to this question were predominantly in favour of the proposition that large charities be required by legislation to have an assurance engagement completed. Many respondents, however, made certain reservations that are set out below.

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<sup>2</sup> The XRB will consider ISRE 2400 as a replacement for the current NZ review standard RS-1 at the next meeting in August. The XRB's strategic approach in developing auditing and assurance standards is to adopt those applicable international auditing and assurance standards, and will consider modifying those standards only if there are compelling reasons to do so.

<sup>3</sup> International Standard on Related Services (ISRS) 4410 (Revised) *Compilation Engagements* (available at: <http://www.ifac.org/>)





- 3.23 Of those responses made without reservation, many noted that due to the exemption from income tax and the large amount of annual operating expenses, larger charities must have transparency and accountability in their financial reporting that can only result from having an assurance engagement completed. It was noted that the audit mechanism will raise the standard of governance among large charitable organisations, providing a charity's board with recommendations for improvements to their financial systems and will potentially reduce the risk of significant matters such as fraud. Others agreed with the research in the discussion paper that suggested that GAAP compliance will not become mandatory unless there is a legislative requirement to do so.
- 3.24 A large proportion of those submissions in support of the above proposition made the comment that the expenditure threshold for "larger" charities ought to be increased. This is further addressed under question 8.
- 3.25 A consistent reservation made across all stakeholder categories was that an assurance engagement is particularly important where charities receive funding from the public or through government contracts. An assurance engagement can provide the public with confidence that the funds are being distributed according to their intended purpose and in the public interest – thereby enhancing the incentive to donate to registered charities.
- 3.26 Some submissions suggested that privately funded charities, i.e. charities not receiving funding through public donations or government contracts should be exempted from the proposed mandatory assurance requirements. These respondents questioned the rationale and benefit behind mandating such charities to make audited financial statements available to the public. One respondent suggested that in order to meet cost-benefit concerns, certain privately-funded charities which meet set criteria should be able to 'opt-out' of having an assurance engagement on their financial statements or be able to opt for a lower level of assurance.
- 3.27 There were also a small number of submissions that did not support the proposed mandatory assurance requirements. These respondents, from both the accounting and charities stakeholder groups, considered that a mandatory legislative requirement to complete an assurance engagement is unnecessary. They noted that the majority of larger registered charities already have their financial statements assured, and that most of those are required to do so either by their constitution or by funding agencies. In this regard, they considered that the Charities Board should have the power to investigate those charities which are not filing assured financial statements in contravention of their constitution and have an enforcement authority to require them to do so.

### **Tiered Approach**

*Discussion paper question 5: Assuming that mandatory assurance is introduced for larger charities, do you consider that:*

- (a) All large registered charities should be required to have an audit completed, or
- (b) That 'less large charities should be required to have an audit or review completed and that 'more large' charities should be required to have an audit completed?



- 3.28 Views were divergent on this question and overlapped significantly with the views expressed at question 4. The majority of those who commented were in support of the tiered approach outlined in option (b), with several also in favour of option (a). Many respondents commented on the need to increase the expenditure thresholds for the different tiers, which will be further explained under the summary to question 8.
- 3.29 In addition to the reasoning provided in paragraph 3.22 above, the several submissions in favour of option (a) reasoned that a review engagement, or “negative assurance”, does not fully satisfy the obligation to provide financial statements that are full, accurate and transparent. These respondents were not convinced that the benefits of assurance outweigh the associated costs for ‘less large charities’.
- 3.30 Those respondents in favour of option (b) considered it necessary to allow for ‘less large’ charities to have the option of negative assurance. Many of these respondents echoed the reasoning in paragraph 3.16 above – that the IAASB standards on reviews need to first be implemented before mandatory compliance is legislated. One respondent noted that the minimum standards for a review engagement must be specified in legislation. Other respondents in favour of option (b) again raised the concern that there is no distinction drawn between registered charities that receive public donations or government contracts and those that are privately funded.
- 3.31 There was another set of respondents who agreed with neither option. Some of these respondents suggested that it should be up to the individual registered charity to elect for itself which model of assurance or non-assurance it would like to have completed. Among charities, there was some concern that ‘less large’ charities may have problems financing an audit or a review, and consequently that the costs would outweigh the benefits. Other respondents noted that there should be a third tier for smaller charities, where non-assurance models such as a compilation engagement were permitted.

### **Measure for Thresholds**

*Discussion paper question 6: Which measure or measures should be used for determining whether assurance is required and, if there are to be tiers, for setting the cut-off point between audit and review?*

- 3.32 In paragraphs 39-46, the discussion paper considered certain options for determining whether a charity is “sufficiently large” to justify mandatory assurance. The options were annual revenue, annual operating expenditure, total assets and employee numbers. The discussion paper proposed that annual operating expenditure was the most suitable option.
- 3.33 There were mixed views on this question, and views that were not specific to stakeholder categories. Roughly half of those who responded were of the view that operating expenditure was the most appropriate measure for determining whether assurance is required. Several other respondents considered that a combination of operating expenditure and annual income or total assets would be more suitable.



- 3.34 Those respondents who favoured operating expenditure as the most appropriate measure of a registered charity's activities, considered it to be more directly controllable and more stable over time than annual income. It was also noted that use of this measure would align with the XRB's proposed tiers for the accounting framework for NFP Public Benefit Entities. The XRB's proposed framework also raised the question of whether or not expenditure should include grants made by a charity to other parties. It was suggested that it would be appropriate to monitor the outcome of the XRB question to ensure full consistency with the proposed measure, if operating expenditure is utilised.
- 3.35 Given that many registered charities experience fluctuating expenditure, other respondents in favour of the operating expenditure method suggested that the amount should be averaged over a two to five year period before determining whether the charity met the threshold for assurance.
- 3.36 There were several respondents who considered that operating expenditure should be used in conjunction with other measures to ensure the most consistent and balanced approach. In particular, some respondents noted that certain charities may not incur significant expenditure but do manage significant assets. Noting that such charities would not necessarily be captured by this measure, an accountability of stewardship should be applied to the assets they hold on behalf of the public. To recognise both operating expenditure and a balance sheet threshold would align the charity sector with the XRB's for-profit model. In opposition to this position, some charity respondents (particularly churches) were against the use of total assets, reasoning that most of the assets of the churches are not used for economic purposes.
- 3.37 Other respondents considered that operating expenditure should be used in conjunction with annual revenue in order to determine whether assurance is required. It was noted that the use of operating expenditure alone allows for manipulation with the netting down of expenditure with income, particularly with the treatment of volunteering. With different jurisdictions adopting different approaches to the choice of measures for determining thresholds for audits and review, it was noted that the proposed legislation for charities in Australia uses a measure based on revenue.
- 3.38 There was also a set of respondents who considered that operating expenditure should not form part of the measure to ascertain whether assurance is required. Several of these respondents preferred a measure based on the level of income from public donations or government contracts. Others considered that it should be set by the market; assurance should only be required when requested by donors. One respondent took the view that it should be left with charities to decide when assurance was appropriate.

## Assurers' Qualifications

*Discussion paper question 7: Do you prefer Option A, Option B or another option in relation to assurers' qualifications?*

- 3.39 In regards to assurers' qualifications, the discussion paper notes that the main issue to consider is whether the qualifications and experience requirements should be the same for all assurance engagements or whether reduced qualifications and experience would be adequate for simpler assurance engagements. The discussion paper set out the following options:
- a. A combination of (i) a higher proportion of registered charities being required to have an assurance engagement completed and (ii) certain non-accountants being permitted to carry out relatively simple engagements; or
  - b. A combination of (i) a lower proportion of registered charities being required to have an assurance engagement completed and (ii) requiring all of those engagements to be carried out by qualified accountants.
- 3.40 The discussion paper noted in paragraph 56 that the preliminary view of MBIE was to favour Option B. It reasoned that there is a significant risk that an unacceptably high number of engagements would not be performed adequately under Option A.
- 3.41 The submissions were almost unanimously in support of Option B. Of the 40 answers submitted for this question, only three were not in favour of Option B and all accounting submissions were in favour of Option B.
- 3.42 Noting that the primary objective of requiring charities to obtain assurance is the promotion of public confidence and trust in the charitable sector, respondents considered that this objective is more likely to be achieved if assurance engagements are carried out by qualified accountants. Some noted that it is critical to demonstrate that assurance is being performed to a high standard so as not to undermine the intentions of the proposed framework and that this can only be achieved by ensuring that assurance engagements are performed by suitably qualified accountants.
- 3.43 Some of the submissions in favour of Option B were made with the following reservations:
- That risk would remain with the assurer;
  - That the operational expenditure thresholds are increased;
  - That retired members of NZICA be included in the definition of qualified accountant;
  - That the definition of qualified accountant with authority to complete an audit or review assurance engagement be widened to include all Chartered Accountants;
  - That the statutory requirements on assurers' qualifications not be drafted so as to discourage the services of voluntary auditors; and
  - Concern that there would be an insufficient number of qualified accountants to carry out assurance engagements to the standards required.



- 3.44 Of the submissions not in favour of Option B, one respondent considered that certain non-qualified parties could be subject to accreditation enforced by the Charities Board for the purpose of completing lower-level engagements for smaller registered charities. Another respondent considered that individuals with a Bachelor of Commerce should be able to complete review engagements for registered charities within the \$500,000 to \$2 million annual operating expenditure range.

### **Compliance Costs**

*Discussion paper question 8: What are your views on the tentative proposal for all registered charities with annual operating expenditure of \$300,000 or more to have an audit completed and \$200,000-\$300,000 to have a review or audit completed?*

- 3.45 There was a divergence of views in response to this question. The majority of respondents considered that the proposed thresholds for requiring assurance were too low. Suggestions for the threshold for an audit requirement ranged from \$100,000 to \$2,000,000, and from \$25,000 to \$2,000,000 for a review requirement.
- 3.46 Those respondents who agreed with the proposed thresholds considered that \$200,000 is a significant amount and therefore needs to be accounted for through either an audit or review engagement.
- 3.47 A high proportion of respondents submitted that the threshold for an audit requirement should be set at a level of \$500,000 (in the majority of submissions) or up to \$2 million. Those who favoured the \$2 million threshold noted that this would bring the proposed framework in line with the XRB's Tiers for NFP Public Benefit Entities. Such respondents reasoned that it would appear inconsistent to permit simple format reporting for entities that have operational expenditure of \$2 million or less, yet require a full audit for those with operating expenditure greater than \$300,000.
- 3.48 Other respondents noted that the tentative proposal described in the discussion paper at paragraph 63(a) would impose mandatory audit or review costs on 20 percent of registered charities. Given this, several respondents across all stakeholder categories raised concerns that there would be an insufficient number of qualified accountants to complete the requisite assurance engagements, particularly in areas outside of the main centres.
- 3.49 Another concern raised by both charity and accounting respondents was that the \$300,000 operational expenditure threshold can be met very quickly by organisations that employ relatively few staff and incur ordinary office expenses. Such respondents questioned whether the associated costs of assurance set at the proposed thresholds would match the benefits, especially where the users of the financial information had no need for an assurance engagement. Concerns were also raised that if the proposed thresholds are implemented, the resulting demand for assurance services will push up the costs. Other respondents noted that no provision appears to have been made for the internal cost to the charity in preparation for the audit, particularly to those who form a group of charities.



### **Mechanism to Increase Thresholds**

*Discussion paper question 9: Do you consider there should be a mechanism for the government to increase the dollar amounts from time-to-time to counter the effects of inflation?*

3.50 The responses to this question were consistently in agreement that there should be a mechanism to adjust the dollar amounts for inflation from time-to-time. It was clear among the submissions that respondents supported the need to future-proof the legislation to ensure that, in real terms, the border between large and other charities is unchanged. In terms of the review period, most responses suggested the thresholds should be reviewed every three to five years.

### **Costs vs. Benefits**

*Discussion paper question 10: Do you have any views on the Ministry's estimates of costs and benefits?*

3.51 The discussion paper includes information in paragraph 58 about the average cost of audits and reviews for different sizes of charity based on data provided by accounting firms that provide extensive assurance services for NFP entities. This data is set out in Table 8 of the discussion paper.

3.52 Responses to this question presented a consistent picture that the costs for assurance were underestimated.

3.53 Several accounting respondents made reservations against publishing proposed costs for an audit – as these are likely to vary significantly between registered charities depending on factors such as the complexity of the entity's activities, the quality of their accounting records, risk, and the competency of the preparer.

3.54 A significant majority of respondents considered that the estimates of costs in the table were underestimated to the point where they held little credibility. Some respondents noted the risk that the information used to base the estimates for costs and benefits would likely include work provided on a pro bono or reduced-cost basis, and reasoned therefore that the costs in the discussion paper are unlikely to represent the true costs if the assurance requirements became mandatory.

3.55 Other respondents cautioned that signifying the cost of an audit may create unrealistic expectations for charities as to compliance costs, and that this may affect the quality of the assurance provided. Respondents from accounting practices noted that no short-cuts can be taken when undertaking an audit. The International Standards on Auditing list the requirements for a certain minimum number of procedures to be undertaken.



- 3.56 Aside from the actual costs indicated, there were also broader concerns about the effect of costing issues under the proposal. Respondents noted that:
- Fewer qualified accountants are likely to offer pro-bono or reduced-cost audit engagements;
  - The general costs of an audit will increase;
  - There are usually additional costs involved in the preparation for an audit that have not been considered under the proposal;
  - There will be an insufficient number of qualified accountants available to conduct an audit engagement;
  - There is a tendency for auditors to increase their costs in years subsequent to the client being “captured”; and
  - A funding scheme should be implemented to assist charities finance the costs of mandatory assurance.

### **Switch to Review**

*Discussion paper question 11: Do you consider that introducing a review requirement into law could encourage some charities that are currently having an audit carried out to switch to a review?*

- 3.57 Responses to this question were varied, with a majority of respondents accepting that some charities would switch from having an audit engagement carried out to a review engagement if it was a cheaper alternative. Many respondents provided reservations and other comments with their responses.
- 3.58 It was accepted that in any tiered regime there will be entities moving up and down the scale of the tiers. Among accounting respondents, it was noted that it would be encouraged for charities currently having an audit to continue with this high level of assurance to promote confidence in the sector. In many cases, charities have an audit completed as a requirement of their trust deed or Constitution and are therefore unlikely to switch to a review.
- 3.59 Several respondents, predominantly charities, supported including the option of a review engagement and noted that they would be likely to switch from an audit to review if it was appropriate. Such respondents also noted that given the increasing pressure on organisations to be cost efficient, the decision to switch to a review is likely to be driven by costs and a preference for the least level of resistance.
- 3.60 Many respondents also echoed the comments to question 3 (paragraph 3.16 above) – that reviews are currently not well understood and that education as to the level of assurance available and the level of assurance an individual charity may need is required. This would raise awareness that a less onerous review option is available and more suitable in some cases. Although it was also noted that, depending on the circumstances of an individual charity, a review may be almost as costly as an audit.



## Further Comments

*Discussion paper question 12: Do you have any other comments?*

- 3.61 While many of the responses to this question have been canvassed in the summary of responses above, there were several additional comments.
- 3.62 Respondents whose charity formed part of a group or association of charities raised concerns about the effects of consolidation. In dealing with this issue, they submitted that consideration should be given to whether an exemption can be applied to certain charities with multiple branches.
- 3.63 Other respondents, particularly those from privately funded charities, suggested that certain charities which would otherwise meet the threshold criteria for mandatory assurance ought to be able to 'opt-out' or apply to the Charities Commission for a waiver if certain conditions are met.
- 3.64 It was suggested that there also needs to be a level of assurance to identify whether charities are acting in a way that is complicit with their purpose, as set out in their statement of intent. Related to this, some respondents considered that the Charities Commission should be given authority to investigate and penalise charities that are consistently lodging financial statements that are inconsistent with the requirements of their constitutions.
- 3.65 In terms of time-frames, one respondent requested that in order to give charities the requisite time to prepare and adjust for the proposed changes, the requirement for an audit or review should not be imposed any earlier than 2016. Another respondent proposed extending the time-frame for providing an audit to the Charities Board from six months to twelve months in order to allow for the preparation of accounts and completing an audit with the financial year finishing in December. It was also suggested that a two year threshold "sensitivity system" should apply to those charities that move between threshold levels before a charity is required to comply with a new level of reporting.
- 3.66 Several charities raised the concern that requiring mandatory audit or review engagements will divert charitable funds away from their intended purpose towards the costs of compliance. In light of this, a small number of charities proposed that a funding scheme be initiated in order to assist with the associated costs of mandatory assurance compliance.





## 4. Conclusions and Next Steps

- 4.1 The consultation process was helpful in ascertaining stakeholders' views on auditing and assurance for larger registered charities. Given the strong responses to questions 4 and 7, it is clear that there is a demand for large registered charities to be required by legislation to have an assurance engagement completed, and that this be done by suitably qualified accountants.
- 4.2 The divergence of views in response to some of the other discussion paper questions suggests that more consideration needs to be given to how assurance requirements should be implemented, how they should be enforced, and who they should apply to. The consideration of these matters is also likely to benefit from the development of the new XRB financial reporting standards for NFP Public Benefit Entities and the upcoming NZICA report concerning the replacement of the Statement of Review Engagement Standards.
- 4.3 The Ministry intends to undertake further consultation prior to reporting back to the Minister with firmer proposals for further public consultation by mid-2013.



#### 4.4 Annex 1 – Profiling of Answers Based on Stakeholder Groupings

Questions	Accountants		Charities		Individuals		Academics		Totals answered	
	Agree	Disagree	Agree	Disagree	Agree	Disagree	Agree	Disagree	Agree	Disagree
1	6	9	9	7	0	1	0	1	15	18
2	9	4	7	6	0	0	0	1	16	11
3	7	12	7	4	0	1	1	1	15	18
4	15	4	14	6	2	0	2	0	32	9
5	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)
	7	9	4	8	0	0	0	1	11	18
6*	Opex	Other	Opex	Other	Opex	Other	Opex	Other	Opex	Other
	12	9	8	11	1	2	1	0	22	22
7	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)
	0	20	2	15	1	2	0	1	3	38
8	Agree	Disagree	Agree	Disagree	Agree	Disagree	Agree	Disagree	Agree	Disagree
	2	17	1	19	0	2	0	1	3	38
9	13	0	18	0	2	0	1	0	34	0
10**	2	12	1	13	0	0	0	1	3	26
11	5	5	11	4	2	0	1	0	19	9
12	N/A									

**Note:** Of the discussion questions which asked whether the stakeholders had “any comments”, there were many responses which reserved comment, some which provided comment without agreeing or disagreeing, and some which either agreed or disagreed without providing further comment. This means that the above table does not necessarily reflect the total number of stakeholders that agreed or disagreed with those questions.

\* “Opex” means operational expenditure.

\*\* To ‘agree’ here, is to either accept the costs or consider them to be an overestimate. To ‘disagree’ means to have the view that the costs are underestimated.



## Annex 2 – List of Respondents

- 1 A H Biss
- 2 Accounting for Charities Trust
- 3 ANGOA
- 4 Archdiocese of Wellington
- 5 ASB Community Trust
- 6 BayTrust
- 7 BDO New Zealand
- 8 Bizwise Consulting Limited
- 9 Brian Perry Charitable Trust
- 10 Brown Webb Richardson Ltd
- 11 Capital Accounting Associates Limited
- 12 Catholic Schools Board Limited
- 13 Central Plateau REAP
- 14 Christchurch Community Accounting
- 15 Community Waikato
- 16 CPA Australia
- 17 CSC Buying Group
- 18 Dixon & Co
- 19 Festival of Colour
- 20 Grant Thornton New Zealand Limited
- 21 Hayes Knight Audit NZ
- 22 Inter Church Working Party
- 23 James Hill
- 24 Joan Craig
- 25 Kaimai Family Television Network Trust
- 26 Karori Anglican Churches
- 27 KPMG
- 28 Life Education Trust (NZ) Inc
- 29 Lloyd Brewerton
- 30 Longview Taurima Trust, Northgate Community Church & Northgate Community Trust
- 31 Manor Group Investment Trust
- 32 Marist Sisters of New Zealand Trust Board
- 33 Massey University School of Accountancy & Manawatu Technical And Legislation
- 34 Special Interest Members Group NZICA
- 35 Methven Aged Persons Welfare Association Inc
- 36 Michael D. Powell, Ross D. Boon, Brian E. Prestidge & Neville C. Goddin
- 37 Neal Schofield
- 38 New Zealand Auditing and Assurance Standards Board (External Reporting Board)
- 39 New Zealand Institute of Chartered Accountants
- 40 New Zealand Kindergartens Inc
- 41 New Zealand School Trustees Association



- 41 North Shore Budget Service
- 42 North Shore Community & Social Services Inc
- 43 Office of the Auditor-General
- 44 PwC
- 45 Raglan Community Arts Council
- 46 River Christian Church
- 47 Roy Glass
- 48 Social Development Partners
- 49 Sothertons Limited
- 50 Te Rūnanga o Ngāi Tahu
- 51 The Third Sector Educational Trust
- 52 Thompson, Lang & Associates Ltd
- 53 Tony Bracefield
- 54 Trust Investments Management Charitable Trust
- 55 Trust Waikato
- 56 University of Auckland Business School
- 57 Wellington Community Law Centre
- 58 Whanganui Community Foundation
- 59 WHK
- 60 Youth Cafe Taupo