18 July 2012

Submission to Ministry of Economic Development

Auditing and Assurance for Larger Registered Charities

Introduction

Recently ANGOA completed a road show with Ministry of Economic Development (MED) on the changes proposed in an MED Discussion Paper to the auditing requirements for larger charities. ANGOA has based this submission on the information gathered in these sessions and further correspondence with member organisations.

Response to Questions

Q1. Do you have any comments on the description of the problem definition?

Media reports highlighting charity spending has put the sector under increased scrutiny for transparency and accountability. The research cited in the discussion paper has highlighted some incidences where poor quality financial practises are being applied in the sector. There is no doubt that accounting skill and knowledge of accounting standards will be of varying quality across the charity sector. This is commonly the case in small to medium enterprises regardless of whether they are private and for-profit or community-based, charitable, and not-for-profit.

As the discussion paper notes there are proposed changes to the accounting standards for the charity sector that should clarify and simplify the accounting practices that need to be applied. Assuming simple yet effective standards are introduced then this will immediately offer a higher level of comparability and quality in the accounting information for charities.

ANGOA does not agree that confidence in charities will be significantly increased, as suggested in the problem definition, by introducing a legislated requirement for audit. It would be more productive overall to focus on the standard for accounting. The comparability of accounts in the public domain by potential donors can be better achieved by improving the standard and effectiveness of accounting practice.

Further, the focus in this discussion paper on audit of financial statements is out of keeping with changes happening in the orientation of the reporting being sought by an increasing number of government funders. The current Government has set specific Goals that it wants to address, and progress on those is to be measured in terms of the ***outcomes*** achieved as a ***result*** of funding. In this context, the details of the expenditure are less significant.

Alongside this shift towards reporting on outcomes is the increasing trend for funders to seek assurance based on measurement of the services provided against established service standards. Service standards may be specified in legislation (especially in the health arena) , in regulation (especially in the social services) or in the contract as a result of negotiation between the funder and the provider. Either way, the focus for audit is the ***quality*** of the ***service***, not the expenditure details.

A further question not adequately addressed in the paper is that of why government might choose to impose greater compliance costs on registered charities when they are known to be a minority among the many thousands of community-based organisations who receive significant amounts of funding from the same mixture of public donations, interest on investments, fees for service, grants derived from gambling, and funding based on contractual agreements with agencies of government.

These other organisations in many cases receive parallel tax concessions to charities, although often under different legislation. Implementation of the proposals in this paper would likely therefore create a disincentive to charitable registration, and possibly even an exodus from registration, and thereby defeat its own stated purpose of increasing accountability.

Q2. Do you have any comments on the description of the objective?

The cost of completing an assurance engagement is a hurdle for many organisations and a reallocation of valuable funding away from the organisation's service delivery to compliance.

The reducing supply of affordable willing auditors and the dearth of available auditors outside the main population centres will combine to further increase the cost and to further shift the balance away from acceptability of requiring full audit for any but the very largest charities.

Q3. Do you have any comments on the description of the options?

No.

Q4. Do you consider that large charities should be required by legislation to have an assurance engagement completed?

Definition of what is considered as a "larger" charity has been set at an inappropriately low level. If charities are to be required by legislation to have an assurance engagement then this should only be for charities with over $2million in expenditure.

Requiring assurance on financial reports is unlikely to give the general public more confidence in a charity. The motivation for giving is more often linked to how the donor feels and how much they know about the organisation's mission, rather than any analysis of whether or not they have an audit.

Funders who may be interested in the financial statements of charities can request an audit as a condition of their grant to gain more trust in the financial statements and, as the figures show, a great majority of charities that have funding contracts already undertake audits as a requirement. In recent years a particular interpretation of the Public Finance legislation has led these audits to focus on the details of expenditure at the expense of the quality of the service and the outcomes achieved. As noted in response to Question 1 above this is changing, so the focus of the Discussion Paper on financial statements alone is somewhat out of step.

Q5. Assuming that mandatory assurance was to be introduced for large registered 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 a review completed and 'more large' charities should be required to have an audit completed?

Keeping the option of an audit or review open for the governance group (committee or board) of the organisation to determine is the preferred approach.

Q6. 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?

Because of the nature of the diversity of the charitable sector no one measure is the best for determining whether assurance is necessary. For example a charity may hold significant assets on behalf of a wide group of constituents but have very little expenditure each year. Another organisation may have significant expenditure but all income is derived from investments on the trust fund.

In these two scenarios the first situation would not be audited and the second would be audited. From a compliance and accountability perspective audit was likely to be more important for the first scenario.

The best means for measuring where audit is required would be based on the average amount of public funding received over a period of at least 3 years.

Q7. Do you prefer Option A, Option B (see paragraph 49) or another option in relation to assurers' qualifications?

A significant concern in the sector is the lack of qualified auditors to complete the audit within the timeframes required. This is especially true in smaller centres. Requiring all audits to be completed by a qualified accountant is likely to further exacerbate the problem. Option B should only be adopted if the level of expenditure set for an audit is significantly increased from the proposed level.

Some alternative solutions to what has been presented in the paper were suggested during the recent roadshow completed by ANGOA and MED. These alternatives should also be considered.

Q8. 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 annual operating expenditure of $200,000-$300,000 to have a review or an audit completed?

The levels of compulsory assurance should be increased. Also the lower band needs to be widened through than proposed. A suggested range is:

- $1m to $2m – audit or review
- Over $2m audit by qualified accountant

This brings the audit requirements more in line with the accounting standards framework.

Q9. Do you consider that there should be a mechanism for the government to increase the dollar amounts from time-to-time to counter the effects of inflation?

Yes, and kept in line with the accounting standards.

Q10. Do you have any views on the Ministry's estimates of costs and benefits?

The costs are believed to be well understated. Strong feedback has been received by ANGOA on this point – from member organisations, from participants in the seminar series, and in discussions with Rowena Sinclair who is quoted in the document on some matters.

The costs are likely to increase significantly should the legislation be enacted as the demand for qualified accountants increases and the current pro-bono audits are likely to decrease should standards tighten.

The benefits offered to both the public and charities are overstated. An audit provides a limited value of accountability and assurance to an organisation whose social purpose has greater meaning than the financial statements being prepared to GAAP standards.

Q11. 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?

The sector appears to have a mixed feeling towards review engagements. However the decision on a review or audit is likely to be a cost driven decision. If audits are not required by external funding agencies but aligned to the legislated requirements for assurance then it is likely agencies would move from an audit to a review engagement.

Q12. Do you have any other comments?

Compliance costs in the charity sector are a point of high sensitivity. ANGOA fully supports the sector to be accountable and transparent in their operations. However we do not believe compulsory audit, as a strategy, can provides the greatest return in terms of charities' accountability. The investment in the sector should be placed on increasing and improving education rather than legislating compliance. The charity sector needs to be empowered to improve capacity and capability to deliver reliable financial reports along with quality social outcome reporting.

If further clarification or discussion is required on any point made in this submission, please contact the ANGOA Coordinator:

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