Submission to Proposed Changes to the Auditing and Assurance for Larger Registered Charities.

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

The research used to help define the issue within the sector was completed on a very small sample of the total number of charities, and it is not stated how this sample was chosen. Robust data and research on a random sample of charities is required to accurately ascertain the scope and effect of any issues with reporting in this sector. Additionally, the effects of the introduction of the new reporting standards for the sector need to be seen, with the hope there is a positive improvement in the reporting.

If the problem is identified as "poor quality financial statements prepared by accountants" – then can this issue be dealt with in another manner rather than requiring another set of accountants (as auditors) to verify the work of the first set? Training for accountants in the issues of reporting for this sector, along with the new set of GAAP standards would seem to be an initial step in the improvement process.

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

Is not the primary objective to increase the quality and reliability of financial statements firstly, **then** consider ways to achieve this (of which assurance and audit is but one).

The paper presumes assurance will provide "increased quality and reliability", at a cost. The effect of the imposition of the new accounting standards could also be said to increase quality and reliability, hopefully at a much lesser cost. Would it not be wise to gauge the effect of the standards before imposing significant increased compliance and costs?

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

Not on the description themselves, but other options are available and these have not been investigated. As mentioned above – the imposition of accounting standards specifically related to the sector should also improve the reliability of reporting for these charities, yet this has not been considered as an option. Training for accountants and preparers of financial statements on the reporting requirements specific to the charitable sector is another.

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

No, not as suggested in this paper, when the definition of large is operating expenditure of $200,000 or more. If the definition for large was over $1m, then the answers would be different.

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?

This question is confusing as "less large" and "more large" are not defined in the discussion paper. If the definition of "large", or the tier that the requirement for assurance is imposed, becomes $1m, then "less large" could be $750,000. That aside, the issue of whether a review is adequate or a full audit is required – this should be based on the particular circumstances of the charity, their accountability to the public, their complexity and their operating environment. It should not be prescribed by legislation.

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?

Annual operating expenditure seems the most reliable measure.

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

Option B – potentially using non-accountants to make judgements on the application of GAAP and accuracy of information contained in financial reports does not seem viable.

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?

Negative. In paragraph 63 d. there is a major assumption that the Cordery and Patel study is "reasonably representative" of the sector. This is a huge assumption based on such a small sample and robust research of the issues and how they can be best addressed needs be undertaken. In paragraph 61 b. the Ministry makes the assumption that having an assurance engagement completed will materially improve the overall quality of reporting – this is an assumption that has not been tested.

There are many charities, defined here as "large", whose circumstances would make the imposition of an audit requirement appear to have little or no benefit to the general public or the charity itself yet require significant costs. For example, imposing audits on Charitable Trusts that do not attract public donations seems to have no obvious benefits. The imposition of audits on trading trusts, based on their expenditure level, would require a substantial increase in costs, and reduce the size of the distributions that Trust is able to make to the community.

The effects of the imposition of audits on "large" charities is not discussed in the paper, other than from an (admittedly) understated effect on costs. If this is imposed on the sector, it represents another cost and administrative burden in a sector that is already struggling with these issues, plus the responsibility of attracting enough funding to complete their missions on a day to day basis.

The imposition of audit requirements would, in many cases, be redundant. Many charities of this size already undergo financial audits and operational audits carried out by funders and government agencies. It must also be noted that a financial audit or financial statements do not always reflect whether the Trust is achieving its mission, which is a critical question that a potential donor or funder looks to answer before giving money to a group.

A final caution is the lack of experienced, suitably geographically placed, qualified and cost effective auditors to complete the engagements that could be required if this legislation is imposed.

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?

If the legislation is imposed, then yes adjustments to reflect inflationary affects seems sensible.

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

The estimates of costs are admitted to be understated in discussion with the Ministry.

The assumption that "users of the financial statements" would obtain benefit over and above the costs incurred has also not been proven. Placing additional compliance costs of an estimated $6.5m on this sector in the current climate of increasingly difficult funding begs the question – where is the money to fund this going to come from?

In the current climate of increasing government concerns about cost v benefits in many different arenas of government spending, it seems unjust to impose a cost on a sector that has no opportunity to recoup the costs when the benefit has not been adequately explored or quantified.

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?

Not without an educative process to inform groups of the difference between the two engagements and the benefits of “switching”. Additionally, many groups have audits performed because these are required by other funders (often government funders) and the option for a review is not available to them.

Q12. Do you have any other comments?

The proposals do not cover Incorporated Societies unless these are registered with the Charities Commission. Understanding that the regulations governing this sector are also under review, it seems prudent to assess the outcomes of these reforms alongside issues within the charities sector.

The unstated rationale is that having tax exemption as a Charitable organisation leads to requirements for higher public accountability. One way to maintain this accountability is through reporting – but **financial** reporting is only a part of this, a bigger issue is whether the group is deserving of the charitable status. Financial reporting may state the group is complying with GAAP, but makes no assertion on the achievement of their mission, or whether they are using their funds and their charitable status to effectively advance that mission.