

9 July 2012

Assurance for Larger Registered Charities  
Competition, Trade and Investment Branch  
Ministry of Economic Development

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## **AUDITING & ASSURANCE FOR LARGER REGISTERED CHARITIES BDO NEW ZEALAND REPLY TO DRAFT PAPER ISSUED IN APRIL 2012**

BDO is one of the leading chartered accountancy firms in New Zealand working in the charitable sector. We have a close association in working with groups within the sector, as well as with the Charities Commission where we are currently running a roadshow on fraud. The comments below are made on behalf of BDO partners nationally. We answer your questions as follows:

### **1. Do you have any comments on the description of the problem definition?**

We support this paper, however we note that the paper only deals with registered charities. This only covers approximately 25,000 charities in New Zealand. According to the Department of Statistics there are approximately 97,000 not for profit organisations in New Zealand. Many not for profit organisations in New Zealand are quite large and represent thousands of members. Our concern is that some of these organisations may opt out of audits which could be inconsistent with what you are proposing for charities, that in some cases have less impact on the NZ public than some not for profits. In our view not for profit organisations need to be included in this paper as well. Whilst you may not be able to monitor their compliance, by making it mandatory to comply creates an element of best practice.

### **2. Do you have any comments on the description of the objectives**

We agree with the descriptions of the objectives set out in paragraph three of the paper.

### **3. Do you have any comments on the description of the options?**

We feel that audit and reviews are well explained, however we are unclear if the independent examination is going to be an option for New Zealand. We would also like to see Agreed Upon Procedures engagements as an option for smaller charities. It is not uncommon for a funding provider to request an audit (at great cost) when an audit isn't actually meeting their needs.

In our opinion there is a place for Agreed Upon Procedures engagements around the expenditure and funds held in their organisation. It's an important fact that many auditors need to qualify their opinions with charities on the completion of income. Hence very little assurance is given around income. If you were to ask the readers of financial statements what they are looking for, I imagine a lot of focus would be on what the organisation has spent their money on and where their funds have been invested. An Agreed Upon Procedures engagement focusing on these items could well be a cost effective option for charities in New Zealand.

In saying this we do appreciate that a lot of work may need to be put into identifying what the Agreed Upon Procedures would be.

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

We agree that larger charities should be subject to audit by law, as they are publically accountable for large amounts of money. Your paper suggests expenditure over \$300,000 is deemed large. We feel this is appropriate.

5. Assuming that mandatory assurance will have to be introduced for larger 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 review completed, and more large charities should be required to have an audit completed?

As mentioned above, in our opinion organisations with annual expenditure in excess of \$300,000 per year should have a mandatory audit. Organisations with annual expenditure of less than that should be able to choose between a compilation arrangement, a review engagement, an Agreed Upon Procedures engagement or an audit.

6. Which 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?

We believe that annual operating expenditure best measures the activities of organisations within the charitable sector. Most charities will try and spend as much money as they have on meeting and promoting the aims of their organisation. It is therefore appropriate to use annual operating expenditure.

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

We prefer option B. In respect of smaller organisations with turnover of less than \$200,000, we would recommend that the financial statements be prepared using the new model to be advised by the XRB. These could be done by a chartered accountant under a compilation arrangement with a compilation report. In that way, consistency with Generally Accepted Accounting Practice would prevail in those financial statements.

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

We agree with an audit being undertaken for organisations with an annual expenditure in excess of \$300,000. In respect of amounts of less than that, the Constitution of that organisation should be the indicator of what level of assurance is required. In the event that the Constitution is silent then we would agree with either a review or an Agreed Upon Procedures engagement being done, except when it is deemed the charity is very small. However, in all cases we believe all financial statements should be completed in the format required by the XRB by March 2015.

9. Do you consider there should be a mechanism to increase the dollar amounts from time to time to counter the effects of inflation?

We agree there should be an appropriate mechanism to deal with changing the dollar amounts applied to the rules. However, this shouldn't be applied annually. It should be applied only when there is a need due to demand.

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

We have no comment to make on this.

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?

In our view this is possible, but again would be driven by the Constitution or the Trust Deed of the organisation. In the event that an organisation is very cost sensitive and has a very low level of assurance need, an Agreed Upon Procedures engagement may be more appropriate.

12. Do you have any other comments?

We would caution the Ministry to look at this in relation to other requirements by grant funders within the charities sectors. We understand that some grant funders such as the Lotteries Commission will not fund grants in excess of a certain amount, unless accompanied by audited financial statements. It may be that consultation with grant funders is appropriate prior to finalising this proposal. It is this area that we feel there will be demand for Agreed Upon Procedures engagements.

One other area we would like included is in regard to qualified audit opinions.

If an auditor qualifies a company's audit opinion they need to report that to the Companies Office, who then follow up with the company and in some cases impose fines.

There is no such requirement for charities. Our concern is that if there are no consequences for qualified audit opinions then charities may present misleading accounts to the public for funds.

BDO actually experienced this with a client, who reported a \$1m loss. The true and fair view was a \$1m surplus. When we asked why they did not want to produce the correct result they said they felt people would not be inclined to give them money if they made \$1m surplus. Due to the magnitude of this, our audit opinion mentioned this issue and we issued a disclaimer opinion. The accounts were filed with the Charities Commission and nothing was done, as the Charities Commission have no powers in this area.

Hence, we recommend that if an auditor issues a qualified opinion (except for the standard "completion of income qualification" on most charities audits), there should be an obligation on the auditor to report this to an appropriate regulatory body. This regulatory body should have the power to take action if it is deemed appropriate.

We hope that our comments and suggestions are helpful. Should you wish to discuss any of the points we have raised or require further information, please contact me.

Yours faithfully  
**BDO NEW ZEALAND**



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