Brown Webb Richardson

Brown Webb Richardson Ltd
111 Avenue Road East
PO Box 146
Hastings 4156
New Zealand
Telephone 06 873 8037
Facsimile 06 876 5211
Email info@bwr.co.nz
Web www.bwr.co.nz

MEMORANDUM

SUBMISSION - AUDITING AND ASSURANCE FOR LARGER REGISTERED CHARITIES

Considering the Impact on the BWR Charitable Client Base

We have undertaken a general review of the discussions paper presented by the Ministry of Economic Development entitled auditing and Insurance for larger registered charities. We now provide the following comments in bullet point form which provide a general basis behind our perception of the value and appropriateness of auditing/review requirements for small to medium sized charitable organisations.

Organisations that do not solicit funds from the public or other charities

- Those organisations that do not solicit funds either from the public or from other charitable organisations through grant applications provide a far lesser risk to the public good as the only funds exposed to the risk of fraud or inappropriate reporting of those funds internally generated by the organisation. These funds are under the control and guardianship of the Trustees/Committee, which is far less likely to benefit from incorrect reporting and presentation of these funds.

Organisations with trading activities

- Specific consideration should be given to organisations with trading activities. Under the proposal organisations whose revenue is generated entirely internally (specifically charitable organisations whose expenditure thresholds are breached as a result of legitimate business activities designed to generate funds for the trust organisation) will be exposed to the same auditing and review requirements as organisations who generate income through external grants and donations. A charitable organisation breaching the expenditure threshold as a result of <u>business operating expenditure</u> is less likely (with reasonable governance and internal controls) to be prone to misappropriation, inadequate reporting and non-disclosure, when compared with organisations whose expenditure (in breach of the threshold) is entirely or predominantly driven by <u>charitable functions</u> or activity.

    - With the exception of fraud (noting that audits are not a guarantee against fraud), irregularities in standard business operating activities are far more transparent than expenditure incurred for charitable purposes. Therefore, there is a reasonable argument to consider the nature of expenditure when looking at thresholds for audit and review. A small business with a low gross and net profit percentage that generates a small profit to be used for charitable purposes will most likely be required to complete an audit/review. The cost to such an entity would be detrimental when considering the available surplus.

- Organisations with a significant amount of expenditure resulting from business operating activities will incur far greater audit and review engagement costs due to the nature, variety and classification of the various expenditure categories.
    - These expenditure categories are likely to be consistent year in year out. Provided proper governance practices exist exposure to fraud will be low.
    - If anything, these organisations would benefit from a review of internal controls on a three yearly basis. The cost of a (publicly published) three yearly internal audit would provide a far greater value for money and assurance that an annual financial statement audit/review.
    - The audit/review costs for trading organisations may be double that of organisations without trading activities. This will create an unjustifiably large burden of cost and reduction in funds available for the public benefit.
    - Secondly, organisations with trading activities are far more likely to employ chartered accountancy practices (applying GAAP) to prepare Financial Statements which further reduces the risk of misstatement, inadequate reporting or non-disclosure.

Who should prepare the financial statements?

- If the primary concerns driving the requirement for audit and review engagements for smaller charitable entities is the appropriate reporting and recording of financial information and presentation of Financial Statements then should the focus not be on the preparers of the statements.
    - Standards set by the New Zealand Institute of Chartered Accountants set the terms and form of all financial reporting requirements, and therefore provide a framework for the presentation of Financial Statements for charitable organisations.
    - To govern compliance with these standards the New Zealand Institute undertakes practice review procedures which assess the compliance with appropriate standards.
    - Where appropriate the governing body (NZICA) rectifies the actions of and/or disciplines those accounting practices that do not comply.
    - Having the Financial Statements prepared and signed off by a Chartered Accountant that holds a Certificate of Public Practice should be more than sufficient (and more cost effective) protection against poor and adequate reporting and misstatement of information.
- One may argue that financial statements do not need to be prepared by appropriately qualified persons, and therefore requiring a chartered accountancy practice to prepare/compile statements for organisations of an appropriate size/classification would add additional cost.
    - If financial statements are incorrectly prepared and an audit/review is required, the cost of re-stating the information will still be incurred by the organisation. If the skills within the organisation do not exist then the auditor will in effect by proxy become the preparer of the financial statements. The

organisation will incur the financial statement presentation cost and audit/review cost at the hands of the auditor.

Will an audit/review ensure adequate disclosure/presentation?

- Even with the existence of an audit/review engagement transparency of information presented in the Financial Statements may still be limited.
  - There will still be sufficient freedom to consolidate and categorise various income and expenditure which will continue to allow those organisations with questionable intentions to hide or avoid disclosing certain financial information.
  - Again, one must ask what the public benefit will be from the inclusion of audit and review engagement requirements for those organisations that do not solicit external charity in the form of grants or donations. Provided regulations are set around the use of GAAP, a non-audited set of financial statements (for an organisation that does not solicit grants/donations) is not at risk of the non-disclosure (hiding) of the type of key information that the Charities Commission is concerned about.

Adequate internal governance

- When considering requirement for an audit for an organisation that internally generates its own funds through passive investment (particularly transparent) and through general commercial business operations, no consideration has been given to the existence of boards and compositions within those boards of trustees.
  - In the event of a moderately sized board containing a large collection of independent professional trustees, it should be reasonable and fair to assume that these trustees can assess the risk and exposure faced by the organisation and therefore determine the need for review and/or audit procedures.

Changing audit environment and expectations placed upon auditors – increasing costs

- With the changing audit environment, and the risk that auditors take to comply with the audit standards, it is fair to assume that audit costs for certain organisations will be substantial in today's terms and will likely be significantly higher in cost as we progress and demand more of auditors.
  - Placing these onerous costs on certain organisations will influence and guide their investment activities.
  - There are a number of large trusts within New Zealand that operate farming activities (high operating expenditure activities), and would therefore be caught within these audit requirements. Those in charge of governing these organisations will now be faced with the consideration of the appropriateness of their investment due to the proposed additional auditing requirements and costs incurred.
  - It is not unreasonable to assume that certain organisations will steer away from direct investment in New Zealand business as a result of this perceived high audit compliance cost, choosing rather to invest in a passively managed

portfolio. This will in turn have an impact on the pool of direct investment funds available to fund business activities within New Zealand.

This firm acts as accountants (and in some cases a director of the firm is a trustee) to a number of philanthropic and other charitable trusts, including

Joan Fernie Charitable Trust	(Philanthropic)
Gwen Malden Charitable Trust	(Philanthropic)
A R Nelson Charitable Trust	(Philanthropic)
H & W Williams Memorial Trust	(Philanthropic)
S R & B J Williams Charitable Trust	(Philanthropic)

The trustees have suitable procedures in place for control and supervision of all expenditures in the approval of accounts for payment and the delegation of duties.

These are Trusts that do not receive donations from the public or grants from government sources.

These are Trusts which operate farming enterprises to produce income available for charitable purposes.

These Trusts gross incomes ranging from $70,000 to $1,700,000.

As farming enterprises if the Trusts' accounts were to be audited notwithstanding that the annual accounts have been prepared by chartered accountancy firm, an independent auditor would be likely to charge $30,000 p.a. for an audit.

In the case of the above trusts the trustees are a mixture of professionals, lawyers and accountants and established farmers.

The Trustees supervise the farm managers who physically farm the properties and payments of any account rendered to the Trust are made through the accountant's firm preparing the annual accounts after payments are authorised by the Trustees

(John F Springford)
Brown Webb Richardson Ltd

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