

Assurance for Larger Registered Charities
Competition, Trade and Investment Branch
Ministry of Economic Development
PO Box 1473
Wellington

Email: financialreporting@med.govt.nz

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Dear Sir/Madam

Auditing and Assurance for Larger Registered Charities

Thank you for providing an opportunity to submit comments on a discussion paper that has been issued by the Ministry of Economic Development (MED) explaining the need for some assurance in the not-for-profit (NFP) sector, and more specifically for registered charities.

Grant Thornton New Zealand has extensive involvement with both the NFP sector and registered charities across the country, not only in preparing financial statements for entities in this sector, but also auditing more than 400 of them. We therefore consider ourselves well placed to assess the impact of the proposed changes on this sector.

Audit assurance only

We fully support the need for all large registered charities to be subject to audit.

The real question is whether this is the only form of assurance that should be given on financial statements? For the time being we believe it is.

We do not support the idea of reviews into this sector, primarily because the concept of review is currently very poorly understood. Furthermore, and on a more technical level, financial statement reviews need to be “anchored” by an audit process to make sure that the financial statements subjected to a review can be relied upon. The possibility of fraud is significantly increased when a review is undertaken as there is no requirement to consider the quality and quantity of any internal controls.

As an alternative to a review, some registered charities have proposed to us that if their financial statements were compiled by a suitably qualified chartered accountant that this would inject the necessary quality and accountability needed. Unfortunately the reality is that in almost all cases, chartered accountants are already preparing the financial statements of large registered charities. Our view is that only an audit will pick up material misstatements caused by human error.

Audit

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Financial tiers

We think that in setting the size criteria the MED must not confuse the number of registered charities it wants to have audited, with its policy development principles of economic significance and public accountability.

We think economic significance is of paramount importance and for this reason believe that the regime should require an audit when annual expenditure exceeds \$1 million per year over two consecutive years. This is \$700k greater than what is currently proposed. We also think that the legislation must have a very detailed definition of what it, and what is not included in the definition of “annual expenditure”.

Although we understand the MED and External Reporting Board (XRB) thinking behind establishing an expenditure only threshold we do have concerns about not introducing an asset threshold as well. There are many registered charities that control millions of dollars of assets that will not be caught by the regime. The XRB in its for-profit framework recognises both an income statement and balance sheet threshold. We think the MED should introduce do the same for registered charities. Based on our knowledge of the sector we think that a total assets threshold should be introduced and that threshold should be \$60 million.

A phased introduction

With the introduction of a new financial reporting framework we would like to see a phased introduction of audit. Initially we would like to see all registered charities that have annual expenditure greater than \$2 million or total assets greater than \$60million being subject to audit, and then a year later the expenditure amount should be lowered to \$1 million. These thresholds have been established – initially to align with the Tier 2 size criteria outlined by the XRB and then it’s lowered to meet the policy objectives outlined in the discussion paper. Our view is that when annual expenditure is below \$1 million the costs of compliance may indeed outweigh the benefits that an audit will bring.

Who should do the audit?

We support the proposal that the audit of registered charities should only be undertaken by a chartered accountant (CA). However, we think that even more direction needs to be given.

We believe the audit needs to be done by an individual who specialises in undertaking financial statement audits. In our view, it makes no difference what sector of the economy the organisation operates in, there is always a need for a high quality audit. There are many chartered accountants who have never undertaken an audit, and we think the MED puts the sector at risk by allowing the audit to be anyone who has a CA designation. We understand that the New Zealand Institute of Chartered Accountants (NZICA) is currently considering this form of licencing to help its members signal where their competencies lie.

As we have represented to various Select Committees, the Financial Markets Authority (FMA) and to the XRB an audit, is an audit and there must never be any compromise on quality, otherwise the integrity of the whole accounting profession is brought into question.

The cost of the audit

While we could be accused of self interest in making this observation, we challenge the analysis of audit costs outlined in the paper, and the perceived cost savings associated with undertaking a review. The amounts cited in the discussion paper seem very low.

No short cuts can be taken when undertaking an audit. International Standards on Auditing (New Zealand) clearly spell out the requirements for a certain minimum number of procedures to be undertaken. Simply put, when the time taken to complete these tasks is costed out at standard billing rates, the average cost of doing an audit far exceeds the amounts identified in the paper.

In the July 2012 edition of the Chartered Accountants Journal the CEO of NZICA notes “there is intense competition in the pricing of audits”. He goes on to say that “while the [audit] firms feel quality will not be compromised there is a possibility, a little down the track that, that they may find themselves under pressure. This raises the risk that corners will be cut.” And he closes the topic by saying “there is enough concern to encourage a serious rethink of pricing strategies”. We agree.

A funding audit?

A clear distinction should be made between a funding audit (i.e. reporting on how any money donated has been spent) and a statutory audit. Many registered charities are currently required to have an audit because of their constitution or trust deed requires it. In this instance the annual audit adequately supports the needs of the funders. However, it should be noted that it is not the only assurance alternative available to registered charities. A “special purpose audit” or “agreed-upon procedures” are other ways that registered charities can demonstrate how they are using the funds they receive.

Audit deadlines

Cabinet papers reveal that the Government wants to tighten up the audit completion deadlines set for companies. We believe that large registered charities should be subject to a similar level of discipline. You can have the best audit in the world, but if it is not completed on a timely basis, much of the value associated with that audit is lost.

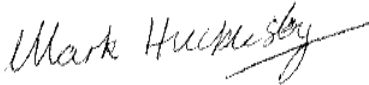
We therefore believe that the four month completion deadline that is proposed for large private companies should also apply to registered charities.

Next steps

While it is important to get the correct level of assurance around registered charities, it is just as important to make sure that no arbitrage opportunities are created as a result of introducing any new assurance requirements. The MED will be well aware of the work of the Law Commission looking into updating the Incorporated Societies Act 1908. We think it is mission critical that a “level playing field” is created and so when setting any new thresholds for assurance all not-for-profit organisations are fairly treated.

Please do not hesitate to contact either of us if further insight or background on any aspect of this submission is needed.

Yours sincerely
Grant Thornton New Zealand Limited



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