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Assurance for Larger Registered Charities
Ministry of Economic Development
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by email: financialreporting@med.govt.nz

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Dear Sir/Madam

Auditing and assurance for larger registered charities

Thank you for the opportunity to review and comment on the discussion paper.

Overall we agree that requiring some level of assurance on charities financial statements will give more confidence to the users of financial statements, improve the quality of those financial statements and therefore lead to better decision making. However we do have some concerns and comments which we have outlined under the question headings as requested.

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

The problem outlined in paragraph 16 of the Discussion Paper is that many charities produce financial statements that currently do not comply with GAAP. This means that users may not get an accurate picture of the financial position and performance of the charity. Currently there is no legislative requirement that charities financial statement are subject to some form of assurance, and, as the Discussion Paper also notes, assurance is needed to provide confidence that charity financial statements present an accurate picture.

- We fully support the need for improved financial reporting by charities, and for the provision of financial information that users can have confidence in. We acknowledge that improved financial reporting, including the provision of assurance, will incur additional costs. While this is in part unavoidable, given that raising money from the public necessitates higher levels of accountability, we also believe that it is necessary to consider whether the benefits of requiring assurance outweighs the costs of providing this assurance and whether there are practical means to minimise such costs.

We note, however that requiring assurance on charities financial statements is only one means to raise the quality of financial reporting in the sector, and, to the extent it is required only for larger charities, it will contribute only partially towards the overall objective.

- To improve the overall quality of financial reporting by the sector we believe a range of measures are required.
- We also note that reporting in the charitable sector comes with its own unique challenges. In particular, financial performance for a charity only forms part of the story. Because charities are service focussed organisations, reporting on and providing assurance on the non-financial aspects will be equally as important as the financial aspects.

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

The charitable sector plays a vital role in New Zealand and it is therefore important that charities be held accountable for their use of resources they collect from the public. It is also important that the public has confidence in the financial information provided by charities and providing assurance on the financial statements of charities has a significant part to play in meeting this objective. We note that paragraph 17 of the Discussion Paper outlines the objectives of charity regulation as:

- a. To promote public confidence and trust in the charitable sector;
- b. To help potential funders and donors to make informed decisions about the charities they will support; and
- c. To promote charities' accountability to the public by providing information about whether the funds or other assets they have obtained from the public are being used effectively and efficiently.

We agree with these objectives and with the objective of the discussion paper to find an appropriate balance between the benefits of improved financial reporting and the benefits associated with requiring assurance over the financial statements.

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

The description of the options available appears reasonable.

We suggest that consideration be given to who should be preparing financial statements of the charities. For example, one possible option that could be considered would be for a qualified accountant or other suitably experienced person to prepare or oversee preparation of charity financial statements. Members of the New Zealand Institute of Chartered Accountants and other professional bodies have standards governing the preparation/compilation of financial statements. While such compilation engagements do not provide assurance, preparation in accordance with such compilation standards may assist in improving the quality of financial reporting.

As discussed below, we do not support the conduct of reviews by non-accountants as we do not believe this will contribute toward improving the quality of financial reporting by the charitable sector. However, an examination or oversight by a suitably qualified or experienced person may contribute toward improving quality.

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

We believe all charities have a responsibility to be held accountable for how they spend donated funds, and therefore all charities should prima facie be required to have their financial statements audited. However, we also believe that to address cost-benefit concerns, charities that meet certain criteria should be able to opt-out of having an assurance engagement on their financial statements or be able to opt for a lower level of assurance.

The larger a charity the more significant impact its activities are likely to have on stakeholders. We therefore believe the size of a charity is a reasonable proxy for determining which charities should be able to opt-out of having an assurance engagement altogether and which charities could opt for a lower level assurance engagement.

5. 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?

When an organisation establishes itself as a charity we believe that there is a valid expectation that its activities should be subject to some form of external scrutiny. Requiring assurance on the annual report of a charity is a way of providing users with some confidence that the information reported is fair. We prefer option (b) as this would ensure charities whose activities have a significant impact on stakeholders are subject to full audit and balance the costs and benefits of requiring an audit by permitting certain charities to opt for a lower level of assurance.

6. 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?

We agree that using annual operating expenditure is an appropriate measure for determining whether assurance is required. We also note that it is consistent with the approach taken by the government and the XRB for other financial reporting purposes.

7. Do you prefer Option A, Option B or another option in relation to assurers' qualifications?

Option B is our preferred option. One of the key objectives for requiring charities to obtain assurance is to promote public confidence and trust in the charitable sector. In our opinion this objective is more likely to be achieved if assurance engagements are carried out by qualified accountants who have the expertise necessary to audit an entity.

We note that the Companies Act 1993, section 199, sets out the qualifications required for a person to be appointed as an auditor of a company. We believe it would be appropriate for auditors of charities to be subject to the same requirements.

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-\$300,000 to have a review or audit completed?

In our view the dollar threshold appears too low. This is because, based on our experience an entity with operating expenditure of about \$300,000, is a relatively small organisation with relatively few staff and other resources available to it. We propose the threshold for requiring charities to have an audit be increased to those with an annual operating expenditure of \$500,000 or more. The threshold to opt for a review would then be charities with annual operating expenditure of \$200,000-\$500,000. Overall we believe this approach would achieve a reasonable balance between the costs and benefits of providing assurance.

We note that some charities that will be outside of this scope may still be subject to external assurance requests from other agencies e.g. Government requirements in relation to receiving government grants for a charity with annual operating expenditure of less than \$200,000.

If the objective is to reduce compliance costs on the charitable sector these agencies may need to reconsider the assurance they require, or the scope of the assurance required.

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

Yes, we agree that there should be a mechanism to adjust the dollar amounts for inflation from time-to-time. We note that this would be consistent with the approach taken in respect of Differential Reporting where the XRB has the ability to revise the size criteria under the Framework for Differential Reporting from time-to-time.

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

No comment.

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 review?

Some charities opt to have an audit completed as a requirement of their trust deed. In our view, many such requirements are included in trust deeds without adequate understanding of the level and nature of assurance provided by an audit, or the range of possible assurance solutions available.

We believe that charities may require education about the level of assurance available and the level of assurance they require.

This would raise awareness that a less onerous review option is available and more suitable in some cases. Although we also note that, depending upon the circumstances of an individual charity, a review may be almost as costly as an audit. Hence the cost savings may not be as great as anticipated.

We also note that charities may need to revise their trust deeds with respect to the level of assurance required. We also note that charities which qualify for a review should be able to opt to a higher level of assurance if they decided that better met their needs.

12. Do you have any other comments?

No other comments.

Please contact Ann Tod on (09) 367 5892 or aatod@kpmg.co.nz; or Simon Lee on 04 816 4678 or sdlee@kpmg.co.nz if you require clarification or wish to discuss.

Yours sincerely



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