



24 July 2012

File Ref: AU/APS/6-0049

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

Dear Sir/Madam

SUBMISSION ON DISCUSSION PAPER – AUDITING AND ASSURANCE FOR LARGER REGISTERED CHARITIES

Thank you for providing the opportunity to comment on the proposals outlined in the discussion paper on Auditing and Assurance for Larger Registered Charities (the Discussion Paper). We note that the Discussion Paper excludes charities that are public entities. As a consequence, charities affected by the Discussion Paper would not be audited by the Auditor-General. However, we have an interest in the suggested use of reviews as an alternative to the assurance provided by an audit, and offer some comments under the headings below.

We have concerns that reviews are not well understood

A review is a relatively new “product”, when compared to an audit. However, there is sufficient evidence, in the form of academic research, to suggest that practitioners as a group do not have a common understanding of the scope of a review and users have difficulty in differentiating between a review and an audit. In our view, the current level of understanding about reviews presents a significant risk to accountability. This risk was highlighted in a recent survey carried out in New Zealand by Dr Nives Botica-Redmayne and Sue Malthus¹. In summary, the main conclusions of the survey were:

- that practitioners from the Big 4 accounting firms perceive a lack of usefulness of limited assurance reports from users and that users experience difficulties in distinguishing between reasonable and limited levels of assurance (associated with audits and reviews respectively);
- that practitioners from non-Big 4 accounting firms perceive a lack of demand for limited assurance engagements from users, without providing specific reasons for the lack of demand; and
- that practitioners from the Big 4 accounting firms consider that much less assurance is provided by a limited assurance engagement than practitioners from non-Big 4 accounting firms.

¹ The supply of limited assurance services: Does one size fit all? An exploratory study of the supply of limited assurance services in New Zealand. February 2011.

A further matter to consider is that a new standard on reviews is about to be released by the International Auditing and Assurance Standards Board (the IAASB) of the International Federation of Accountants. This standard, which will become the applicable standard for review engagements in New Zealand, is much more comprehensive than the existing New Zealand standard. We would therefore recommend that proposals for review engagements are evaluated in the context of the new IAASB standard, because using the existing New Zealand standard as a basis for evaluation is likely provide misleading results.

We are concerned with the suggestion that reviews can be carried out by a layperson

A review of historical financial statements is a specialised process, just as the audit of historical financial statements is a specialised process. We are concerned that the Discussion Paper suggests that a reduction in the level of assurance (when compared to an audit) can be accompanied by a reduction in the professional competence and due care by the practitioner because the risk associated with a review is perceived to be less than an audit. We therefore support the preliminary view, in paragraph 56 of the Discussion Paper, that requires all engagements (audits and reviews) to be carried out by qualified accountants.

The standard on reviews requires the reviewer to have existing experience in carrying out assurance engagements. Such experience includes possessing a sound understanding of the environment in which the entity operates in order to conduct effective inquiry and analytical procedures. This requirement has at least two implications for a review – as follows:

- The involvement of an experienced reviewer has cost implications in that the review might be performed more quickly than an audit, but the average hourly rate is likely to be higher; and
- The level of knowledge required for a review is best obtained through an audit. In our opinion, a review is most effective when it supplements an audit. This typically arises when a review is carried out on the half-year accounts to supplement the annual audit. In making this comment we are not suggesting that charities have an annual audit and then a 6-monthly review. Rather, we are saying that reviews are most effective when they are associated with an audit instead of being the sole form of assurance.

We are concerned that reviews are considered to be a low-cost alternative to an audit

The attraction of reviews, particularly to those who pay for assurance services, is that reviews are perceived to be a low-cost alternative to an audit. Although largely untested in practice, the assurance/cost trade-off between audits and reviews of small entities may not be much – particularly when the standard governing review engagements does not require a management letter to be provided to the entity. The management letter is often regarded as being more useful (particularly to governors and managers of entities) than the assurance report on the financial statements. Also, any cost savings are unlikely to be significant – particularly where the number of transactions is low, and given that the reviewer is required to be an experienced practitioner.

We have a concern that the Discussion Paper attempts to specify the fees for audits and reviews when the fee for such engagements must also take account of the nature of the charity (in addition to its size – as measured by its expenditure). Also, many practitioners do not charge the full cost for their services in

recognition of the charitable objectives of the entity they are auditing or reviewing. In some instances no fee is charged by the practitioner.

A further matter (as noted above) is that in the future review engagements will need to be carried out under a new and more comprehensive review standard. We believe that the new standard will place more rigorous requirements on review engagements and that the more rigorous requirements need to be reflected in the evaluation of reviews versus audits.

Concluding comment

In our view caution should be applied when advocating a review as a means of assurance, for the reasons referred to above. It is important that the stakeholders who make the decision about what form of assurance is most appropriate for their charity have a good understanding of the limited assurance provided by a review, and carefully select a suitably qualified accountant to carry out a review engagement. Reviews should not be purely seen as a low cost alternative to an audit, they are different in nature and provide very different levels of assurance.

We trust that this feedback is helpful. Thank you for providing us with the opportunity to comment.

If you wish to discuss any of the matters in this letter, please contact Roy Glass or myself.

Yours faithfully

A handwritten signature in black ink, consisting of a large loop on the left and a long, horizontal stroke extending to the right.

Greg Schollum
Assistant Auditor-General
(Accounting and Auditing Policy)