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Strong organisations for thriving communities

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Submission to Ministry of Economic Development

To financialreporting@med.govt.nz

Auditing and Assurance for Larger Registered Charities

Social Development Partners is a national network of voluntary organisations, covering a diverse range of education, social service, health, disability and community services. We are a membership organisation, and are involved in a range of information, capacity building and advocacy work. We have recently changed our name from the NZ Federation of Voluntary Welfare Organisations, and have been providing a collective voice for the sector for over 40 years.

We welcome the current attention on financial reporting standards, and see this discussion paper as closely related to current work to provide for greater consistency and transparency of accounting in our sector. We welcome this attention to issues for the charitable and not for profit sector, which we consider has been not well understood or served by legislation in the past.

Thank you for the opportunity to attend seminars to discuss the issues raised in the paper, this was a valuable opportunity to create awareness and as well as share information and experience of the issues you raise.

Your paper highlights the issues that there is apparently significant under performance in terms of 25% of organisations already not meeting their own constitutional requirements. We consider that there needs to be significant awareness raising and education in the sector, as well as resources committed to access and affordability issues for audit and assurance requirements to be effectively used, whether they are mandatory or not.

We would also like to see frameworks and standards apply to all community organisations, not only to Charities, and made this point in our recent submission on reforming the Incorporated Societies Act: 'It is our understanding that standards for all organisations, whatever their legal status, would be contained in the same framework, and we see wisdom in this. As there are such significant variations in size and activities, and many common elements in audit and accounting processes, that accounting standards should be contained in one set of standards rather than spread over different legislation.'

Q1. Do you have any comments on the description of the problem definition?

Social Development Partners does not agree that confidence in charities will be significantly increased, as suggested in the problem definition, by introducing a legislated requirement for audit.

We are aware that skills and knowledge of accounting standards is of varying quality across the charity sector. This is commonly the case in small to medium enterprises regardless of whether they are private and for-profit or community-based, charitable, and not-for-profit.

We consider that the introduction of financial standards, and the information and education and associated with the introduction of standards specifically designed to be useful and relevant for the sector will significantly assist in improving this situation, without further legislative requirement.

There is a significant journey ahead of our sector in the introduction of accounting and assurance standards, and at the same time, many organisations are actively providing accountability for government services and contracts as well as to other funders. With the considerable diversity of size and type of organisations, and varying requirements for accountability to different funders and contracts, we consider that public trust and confidence is a more complex issue than audit and assurance requirements.

Q2. Do you have any comments on the description of the objective?

The cost of completing an assurance engagement is a hurdle for many organisations, and a reallocation of valuable funding away from the organisation's service delivery to compliance costs.

The reducing supply of affordable willing auditors, especially in rural areas, will combine to further increase the cost and to further shift the balance away from acceptability of requiring full audit for any but the very largest charities.

Q3. Do you have any comments on the description of the options?

It is useful to see the definition and difference between audit and review clearly spelt out, as there is very little understanding of the options available to organisations at the current time.
We consider that both options need to remain available, with attention given to ensuring that standards for reviews are developed as part of introduction of changes to financial reporting frameworks. Many organisations wil voluntarily adopt such practices if the service is understood and available.

Q4. Do you consider that large charities should be required by legislation to have an assurance engagement completed?

Definition of what is considered as a "larger" charity has been set at an inappropriately low level. If charities are to be required by legislation to have an assurance engagement then this should only be for charities with over $2 million in expenditure.

Q5. 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?

If mandatory assurance is introduced for 'large charities', it should not be mandatory for others. Many charities (and not for profits) of all sizes wil use audit and reviews at their own discretion, to satisfy funders and their own constitutions.

Setting thresholds will always create issues for those organisations moving across them according to growth and retractions of projects, funding and activities. For instance our own organisation has moved between the $200,000 and $300,000 annual operating expenditure categories several times in ten years. It would be very inconvenient to be required to have different levels of assurance at different levels – better to ensure that standards and assurance is clearly understood and available at affordable level, for us to make the relevant decisions for our circumstances.

There are probably not enough auditors available to provide assurance services for all organisations with an annual operating budget of over $200,000. If the threshold was to set at this level we consider that the Ministry of Economic Development would need to provide some funding and support to ensure that assurance services were available and affordable.

Q6. 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?

Because of the nature of the diversity of the charitable sector no one measure is the best for determining whether assurance is necessary. For example a charity may hold significant assets on behalf of a wide group of constituents but have very little expenditure each year. Another organisation may have significant expenditure but all income is derived from investments on the trust fund.

In these two scenarios the first situation would not be audited and the second would be audited. From a compliance and accountability perspective audit was likely to be more important for the first scenario.

The best means for measuring where audit is required would be based on the average amount of public funding received over a period of at least 3 years.

Q7. Do you prefer Option A, Option B (see paragraph 49) or another option in relation to assurers' qualifications?

Generally we consider Option B preferable.

As mentioned, significant concern in the sector is the lack of qualified auditors to complete the audit within the timeframes required. This is especially true in smaller and rural centres. Requiring all audits to be completed by a qualified accountant is likely to further exacerbate the problem. Option B should only be adopted if the level of expenditure set for an audit is significantly increased from the proposed level.

See Q5 for suggestions about the need to provide support for assurance services if they were set at the thresholds recommended in this paper.

Q8. 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 an audit completed?

The levels of compulsory assurance should be increased. Also the lower band needs to be widened through than proposed. A suggested range is:

- $1m to $2m – audit or review
- Over $2m audit by qualified accountant

This brings the audit requirements more in line with the accounting standards framework.

Q9. Do you consider that there should be a mechanism for the government to increase the dollar amounts from time-to-time to counter the effects of inflation?

Yes, and kept in line with the accounting standards.

Q10. Do you have any views on the Ministry's estimates of costs and benefits?

The cost of assurance at 1.25% as a proportion of annual operating income as estimated in this paper appears reasonable at first impression. But the reality may be very different.

The costs are often considerably more than this, and more importantly, finding suitably qualified accountants can be very difficult at present. So that the costs are likely to increase significantly should the legislation be enacted as the demand for qualified accountants increases and the current pro-bono audits are likely to decrease should standards tighten.

The benefits offered to both the public and charities are overstated. An audit provides a limited value of accountability and assurance to an organisation whose social purpose has greater meaning than the financial statements being prepared to GAAP standards.

Q11. 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?

The sector appears to have a mixed feeling towards review engagements. However the decision on a review or audit is likely to be a cost driven decision. If audits are not required by external funding agencies but aligned to the legislated requirements for assurance then it is likely agencies would move from an audit to a review engagement.

Q12. Do you have any other comments?

In the current environment there is a significant emphasis on being able to demonstrate the difference that organisations are making in the community, and this is being reflected in changing perceptions and requirements from many directions – in our policy and funding relationships, in governance and management spheres and in public image and media.

Balancing different accountabilities and compliance is a delicate and dynamic balancing act for all organisations, which requires frequent governance and management attention and resource.

Social Development Partners are supportive of the moves to introduce financial reporting standards, as we believe that it will provide useful and relevant information to assist organisations in making these decisions and developing the skills necessary to ensure organisations are making the difference they want to achieve.

At this stage we consider that the investment in the sector should be placed on increasing and improving education rather than legislating compliance. The charity sector needs to be empowered to improve capacity and capability to deliver reliable financial reports along with quality social outcome reporting.

Thank you for the opportunity to make this submission.

Yours sincerely

Tina Reid
Executive Director