A Money-Saving Tip for Your Small to Medium Charity
By Frank Lieshout and Craig Yarndley

As a person involved in providing charitable services you will know that a charity is always chasing funds to meet its charitable purpose so rarely has spare funds to cover administration costs. Obviously the one size fits all mantra doesn't work in the charities space as our charities come in many shapes and sizes. Generally speaking, the bigger ones have economies of scale to, firstly make themselves known nationwide amidst a lot of "noise", and secondly garner funding at a level that means they are in need of an audit. Even though this article may be of interest to some larger charities, it is the small to medium charities that this article may benefit.

While not all NFPs are charities, this article is directed at the charity sector because currently they are the sector that the new Reporting Guidelines are targeted at (regardless of the entity structure utilised). Our understanding is that eventually most of the non-charity organisations of the NFP sector will also be captured by these reporting guidelines when the Incorporated Societies Act is updated. As a matter of interest, the NZ NFP sector is made up of over 114,000 entities with approximately 27,000 of them charities.

Many years ago, it was common for annual accounts to be prepared by the treasurer (not always an accounting-savvy person) ***and if possible, the organisation had a "mate" or a "mate of a mate" prepare the audit because the constitution or trust deed said you needed an audit.*** If there was a cost it was most likely to be a gift or thank you to the person that did the audit.

After the collapse of Enron in 2001 the rules around auditing changed quite dramatically mainly in terms of who could do them and what the process was in conducting them. This lead to a lot of "mates" and even small to medium accounting firms exiting audits because of the new rules and process required to complete them that was imposed by their membership organisations and legislation (***effectively a small charity is required to be audited as if it was a multinational company)***. This change in auditing requirements came with a larger price tag for audits than what the charitable organisations were able to pay. You could say that these changes brought into this space what is referred to as a review engagement.

The difference between what the "mates" used to do and what review practitioners do today is primarily adhering to regulations (still a flow-on from Enron) from the membership bodies and regulators, through structure and process. ***While the outcome of the review may be the same as the "mates" audit the time and effort required to get the result and the paperwork required to back up the outcome is like chalk and cheese.***

You may be asking ***"What is the difference between an audit and review?"*** Both give a level of assurance regarding the financial statements; however, the difference is the level of assurance ,the type of report provided and the nature of the procedures.

	Audit	Review
Level of assurance	**A reasonable or high level of assurance** about whether the financial statements as a whole are free from material errors or fraud. Reasonable or high assurance is not absolute assurance.	**Limited assurance** about whether the financial statements as a whole are free from material errors or fraud. Limited assurance is less than reasonable assurance.
Report provided	**Independent Auditor's Report** Opinion is expressed in a positive form, e.g. "The financial statements are free from material misstatement".	**Independent Review Report** Conclusion is expressed in a negative form, e.g. "Nothing has come to our attention that causes us to believe that the financial statements are not free from material misstatement".
Nature of procedures	Procedures normally involve detailed tests of accounting records using techniques such as inspection, observation, confirmation, recalculation and re-performance, as well as inquiry and analytical review.	Procedures are primarily based on inquiry and analytical review.

Time doesn't stand still, not only has there been movement in the audit/review space, but we have also had a change in reporting requirements. ***The organisation responsible for accounting and auditing standards*** (The External Reporting Board - or XRB - an independent Crown Entity responsible for accounting and auditing & assurance standards in New Zealand) ***has created a mandatory set of new reporting requirements for everyone who produces financial statements in New Zealand.***

In the case of charities, the reporting requirements, have been reflected within the Charities Act 2005 which means that ***if you are a charity, regardless of your size, you must prepare your financial statements as directed by the XRB because the Charities Commission consider financial reporting to be one of the most important duties a charity has, and they treat it very seriously.*** Financial

reporting is the way charities communicate how they are advancing their purposes to the public and is how the Charities Commission monitors them to ensure they continue to meet the requirements of registration.

Because many charities are still operating the same governance model as they had back in the day when "mates" helped and treasurers were whoever put their hand up, ***the Charities Commission have found that very few charities have been able to be compliant with the new reporting.*** A recent Department of Internal Affairs audit showed that ***only 59% of charities are meeting their legal financial reporting requirements.***

"So, what if my charity doesn't comply with the new regulations?", you might be thinking. "Are there consequences?" Yes…from fines to possible de-registration. They can be fined up to $50,000 AND in certain cases the individuals responsible for the governance of the charity (e.g., every officer/trustee/board or committee member) can also be held liable for the fine.

Depending upon the level of non-compliance, there is a risk of de-registration. Becoming de-registered could result in several issues for the charity, including:

- Tax implications
  - The charity has **twelve months** to distribute its assets to another registered charity or give its assets to charitable purposes. Assets which have not been distributed within twelve months of de-registration will be taxed by Inland Revenue.
  - The charity **may** also lose donee status from Inland Revenue. This could result in any donors to the charity not being able to claim a tax credit for the donations paid.
- Funding issues
  - Some larger funding organisations require charities to be a registered charity to be considered for funding. Being de-registered would therefore limit funding opportunities.

Not only is the proper preparation of the financial statements an issue, ***they must also be audited or reviewed by someone qualified to do so***. A common question we get is whether the organisation's financial statements need to be looked at and if so, which level of overview is needed - an audit or a review? The first indicator is whether there is any legislative reason to look at the accounts. An example of a legislative reason is the Charities Act 2005 42D which notes:

If your total operating expenditure for each of the previous two accounting periods was:

- **over $500,000 (medium)** – your financial statements must be either **audited** or **reviewed** by a qualified auditor; or
- **over $1 million (large)** – your financial statements must be **audited** by a qualified auditor.

If the answer to the above two questions is 'No' for your charity, then you refer to your own rules, which will either be a constitution or a trust deed. If these are silent on the issue, then the answer is 'no'. At that point, you simply need to produce your financial statements in the correct format. If the answer to either of the above questions is 'Yes', then the answer is self-explanatory as to whether your accounts need to be reviewed or audited. It is a misconception that ***every*** charity's financial statements need to be either audited or reviewed.

Many charities' rules / trust deeds are old and still refer to the term 'audit' because they were written back in the days prior to the regulatory changes we've just shared with you. As mentioned,

audits in those days were simpler, not necessarily required were seen to be 'best practice'. ***In today's environment the chances are a review will easily suffice*** and in some instances the organisation may decide to have no review or audit. A word of caution here though, if your charity is reliant on external funders, it is common for the funder to request the financial statements to be either audited or reviewed as a condition of the funding.

So, the money saving tips are as simple as:

- **a rule change –** ***a review will be less expensive than an audit***; and in some cases, nothing is required, so is less expensive than either one!
- **specialist reviewer** – find a ***professional who reviews*** rather than audits
- **technology –** the use of technology brings efficiency and less reliance on the location of the professional
- **reviewer location** – costs are less outside the main centres