

## Not For Profit groups - Need for Audit or Review

### **1. Extract from NZICA NOT-FOR-PROFIT FINANCIAL REPORTING GUIDE**

1.27 In some cases a review of the financial statements may be a more cost-effective option than an audit. For example, if only members of the entity, or a third party such as a funding body, need to know that the financial statements comply with Generally Accepted Accounting Practice (GAAP), an audit may not be needed to provide the level of assurance these users require. Entities considering a review rather than an audit need to decide whether a review will provide the level of assurance required. They must also have authorisation from members or the third party for a review rather than an audit. An incorporated society may be able to change its constitution to specify that a review of the financial statements is permitted. The Constitution or Rules will set out the procedure required to make the appropriate changes.

### **2. New Dialogue December 2007: the magazine of the New Zealand Federation of Voluntary Welfare Organisations**

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It's almost that time of the year again when networking conversations turn from "where are you spending your holidays" to the more pressing question of "and do you know of a (good/cheap/available) auditor?" Sometimes it seems that voluntary organisations pounce on anyone foolish enough to carry a calculator in their handbag, identify them as an accountant, and expect them to be qualified to carry out the 'required' audit.

We would like you to spend more time networking positively this year and less time trying to find an elusive auditor, because we believe you will be more satisfied with your accountant if you really know what it is that you need. We find that too often organisations, their members and funders demand an audit when it is not really necessary.

It has often been said that audit is the most misused word in the English language. Historically, it described the verbal account given by a steward to the landed gentry. The problem is that the demands for this simple accountability mechanism have exploded in what Michael Power calls our "audit society".<sup>1</sup> Audits (especially audits of financial statements), have developed into complex engagements.

An audit of financial statements is designed to provide a high but not absolute level of assurance on financial statements. It may be requested in order to enhance the degree of confidence a reader has in the financial statements. This is *not* an opinion on the financial viability of the entity, whether the entity has an effective system of internal controls, or whether fraud has occurred in the organisation.

The quality of financial statement audits has been receiving increased focus, especially in the wake of significant international corporate collapses. Increasing government and regulator intervention has intensified the demands on auditors. Increased risks have led to increased time spent on audits and auditors' insurance costs. These costs need to be recouped somehow – and this normally means increased fees to clients. It can also mean that it's harder for voluntary organisations to find an auditor willing to undertake this work *pro bono*.

Funders and members of voluntary organisations are right to seek external assurance, but we suspect too much is expected from the audit process and that an undue reliance on audit is not helpful. Alternatives to requiring audited financial statements include:

- *An audit on something other than the financial statements.* For example, a member of the Institute may be engaged to express an opinion on whether the entity has complied with the terms of a grant.
- *A review engagement.* This provides a moderate level of assurance, relying on mainly analytical procedures to express an opinion on the financial statements. As with an audit, assurance skills and techniques will be applied, but the timing and extent of these will be more limited than an audit engagement.
- *An agreed-upon-procedures engagement,* where a member of the Institute agrees with the client to perform specific procedures with respect to financial information. The report from such an engagement will present the evidence collected to the user, i.e. report on factual information.
- *A compilation engagement.* In this engagement a member of the Institute compiles the financial statements with professional competence and due care. The member must read the compiled information and consider whether it is free from obvious material misstatement. In addition, the member must ensure that the information compiled is consistent with their understanding of the entity and with the information from which the information was compiled.

While the first three of these services should be undertaken by an accountant independent of the entity, independence is not a requirement for a compilation engagement (but the report should make a statement about this, if it is not so).

We recommend that voluntary organisations consider what they need and then identify which services will best meet those needs after taking into consideration the expectations of members, supporters and other funders. For example:

- Members or supporters may simply require financial statements that have been prepared by a qualified professional and presented in accordance with an accepted reporting framework (a compilation may suffice);
- Funders may want assurance that the organisation is complying with the terms of the grant, including that the grant money was received by the organisation and expended for the purpose intended (and could ask for an audit on this issue).

One consideration in deciding on appropriate accountability mechanisms is the cost involved compared to the benefit. Because of the decrease in risk, and time spent on procedures, the costs reduce as assurance levels reduce. In addition, voluntary organisations may find it easier to locate a Chartered Accountant willing to undertake for example, a review, as the pool of available suitably qualified Institute members is wider. The need to comply with the Institute's Code of Ethics relevant engagement standards applies across all work undertaken by Institute members. If you do decide to change from requiring audited financial statements, you may also need to change your Constitution or other founding document to reflect this.

Discussions on levels of risk, assurance and accountability will be ongoing. This article highlights different types of assurance services that are available, to help you to decide if you are getting what you need from your Chartered Accountant. If you would like a copy of our brochure that explains this information in more depth, or more information on these processes, please contact Professional Standards staff at the Institute ([psd@nzica.com](mailto:psd@nzica.com)) or visit our website [www.nzica.com/nfp](http://www.nzica.com/nfp) and explore the audit pages.