

## FOCUS ON NOT-FOR-PROFIT SECTOR

# Audits are not just for profit-making groups

But a customised review may be cheaper, and more relevant

## Craig Fisher

A common feature of not-for-profit organisations is that they rely on some form of public money. The money may come directly from the public as in fundraising by known charities, or indirectly via funding for social, health and other services from government funding agencies.

Because of this there has been a general expectation that not-for-profit bodies will obtain an independent audit of their annual financial statements. Many funders require audited financial statements as a condition of their funding.

Logically most people would agree this is sound and sensible. An audit provides a

level of independent assurance over the financial statements, which in turn should help to protect publicly provided funds. So why are many not-for-profit organisations increasingly struggling with the audit requirement?

The challenge is usually felt most keenly by the smaller not-for-profits. For these organisations the cost of an audit relative to their turnover and assets can be prohibitive. In the past many have relied on finding a friendly chartered accountant who is willing to perform an audit on an honorary or semi-honorary basis.

However, these people are increasingly hard to find. The reasons include increased paid employment and increased career pressures,

leaving less time and energy.

Potential auditors are also deterred by an increase in professional liability and risk; that concern applies equally to non-paid engagements. The New Zealand Institute of Chartered Accountants monitors adherence to its professional standards on a reasonably vigorous basis as part of its public protection role.

Many accounting professionals are sticking to their specialisations resulting in fewer auditors.

Just as New Zealand has gone down the path of adopting International Financial Reporting Standards, so it is also following the move to internationalisation with auditing standards.



**CRAIG FISHER:** Many in the not-for-profit sector don't understand what an audit is

Over the next two years New Zealand will progressively introduce the International Standards of Auditing as the standards which will define an audit. This change may also make some accountants reassess their provision of audit services.

In some cases not-for-profit organisations may not need

an audit.

Audits are complex and impose a great deal on the auditor. An audit is like the complexity and expense of a Range Rover, when maybe a mountain bike will do.

In my experience, many within the not-for-profit sector do not truly understand what an audit or a set of generally accepted accounting practice compliant financial statements are. As an accounting professional, my profession must take some of the blame for that as well as being part of the solution.

Many within the not-for-profit sector believe an audit means getting some annual financial statements prepared for an AGM, or someone coming in to check for fraud.

For many funding bodies it is an easy way to enforce compliance and hopefully get some rigour into the information they are receiving.

However, often they are expecting that it will provide assurance that their funds have been spent as they intended.

It generally won't. In the vast majority of cases no one has taken the time to explain to the funding bodies the cost of their compliance request

– which can often be a large proportion of the funding they are providing, especially for smaller entities.

It's therefore crucial that what is needed is what is being requested. Other options are available.

A review engagement also provides independent assurance. It involves less detail than an audit but comes at a lesser cost. Agreed procedures can be performed to assess how particular funding has actually been spent. For funding bodies this approach can be much more effective both in terms of their specific assurance needs and cost.

Sometimes having an independent chartered accountant prepare the annual financial statements is all the rigour that is truly needed.

The challenge with all these options is taking the time and effort to consider what is required. But isn't getting what you really want worth it?

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■ The views expressed are his own

## Reviews still an alternative to audits

By Craig Fisher FCA

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Back in 1998, I wrote an article for this *Journal* on review engagements and how these were sometimes a useful alternative to audits. Ten years on, it is interesting to note how enduring this message has been. In fact, in recent years it seems that changes in the audit world and the wider economy have supercharged the need to consider alternatives to audits.

### The issue

Independent assurance over financial statements is needed by many different stakeholders for many different reasons. Examples include non-actively involved shareholders wanting assurance over their investment, entities wishing to show credibility in their financial statements to assist in their efforts to attract funds, funding bodies wanting comfort over their decision to continue funding, and not-for-profit organisations wishing to provide independent assurance to members of their financial stewardship, to name but a few.

In the past in New Zealand, this independent assurance has usually been delivered by an audit of the financial statements of the entity. However, the audit is only one type of assurance engagement, and as we all know, one size doesn't always fit all.

Added to this, the perception is that auditors' lives have become harder in recent years, thanks to such issues as:

- high profile corporate collapses resulting in increased scrutiny on auditors among others
- increased regulator focus on auditors
- a more litigious society and the resulting impact on professional indemnity insurance costs
- a move to International Standards of Auditing (ISA) which are longer and more detailed than past NZ Auditing Standards
- the ongoing challenge to attract and retain qualified staff
- acknowledgement by our Institute and Practice

Review Unit that audits are often an area of potential risk.

All of these issues point the New Zealand market towards a potentially declining number of auditors. However, in many cases, those that are auditing will be more specialised as a result.

In some sectors this supply side issue is already starting to be felt. An example is in the not-for-profit sector, where many organisations are finding it harder to get auditors. Accordingly, this is driving people to more closely consider the type of engagement they need.

### The options

In terms of formal independent assurance engagements the Institute currently has two main types. An audit provides a positive opinion on a subject matter based on a detailed suite of auditing standards and involving a fairly comprehensive level of work. A review provides a negative assurance opinion based on a review standard and guideline. Less assurance but involving less work and, accordingly, it comes at a lesser cost.

The purpose of this article is not to explain audits and reviews in detail. However, for an excellent high level summary of these, readers should refer to some very helpful information sheets titled *Understanding Services Available from our Members*, which are available on our website at [http://www.nzica.com/NavigationMenu/Publications\\_Resources/NotforProfitSector/AuditandAssurance/Finalversion.pdf](http://www.nzica.com/NavigationMenu/Publications_Resources/NotforProfitSector/AuditandAssurance/Finalversion.pdf)

These documents also explain some other non-assurance engagements such as agreed upon procedures and compilation engagements that many organisations have also found to be viable options that suit their needs better than a traditional audit.

These information sheets have been written to help users understand the different options available to them, which is a very important step in ensuring

We have been continuing to work very hard to ensure that what we do is in line with international best practice

they receive the appropriate service. Sadly it is my opinion, that as accounting professionals we have not always been very good at explaining the options and implications of these to non-accountants who need our services. Providing these documents should help address this to some extent.

### Current state of reviews in NZ

If a Chartered Accountant wants to perform a review they currently have the following pronouncements to refer to: RS-1: Statement of Review Engagement Standards and RG-1: *Guideline on Performance of a Review Engagement – Financial Statements*.

However, these documents date back to 1989 and are in need of updating to reflect the current environment and to ensure they are in line with existing best practice. Accordingly, the Professional Standards Board has a project and a working group now underway to achieve this. At the same time we have been continuing to work very hard to ensure that what we do is in line with international best practice and ideally assist in the development of an internationally acceptable review standard.

### International best practice

New Zealand Chartered Accountants and standard-setters now operate in a more global environment than ever before. This gives us the benefit of tapping into

international best practice as well as adopting standards with international rather than just local credibility. Such credibility can significantly assist users in their understanding of and in their adopting of different types of engagements such as reviews.

Our Professional Standards Board has been aware of the potential rise in demand for alternatives to audit for some time. Accordingly, we have been active in raising this issue internationally over the past few years. While that may seem a long time to some, a reality of global standard-setting is that often influencing such matters can take time due to the wider range of conflicting demands from a much wider group of stakeholders.

However, we have had some recent success in raising this issue at an International Auditing & Assurance Standards Board (IAASB) National Standard-Setters meeting. At this recent meeting in Paris, our past lobbying on this issue resulted in New Zealand being requested to present a paper on reviews and our thoughts on why this area needed more priority on the international standard-setting agenda. This received a very positive hearing with the result that New Zealand is now leading the development of a scoping discussion document. This is being put together in conjunction with Canada and South Africa – other countries that have also seen an increasingly

pressing need for internationally acceptable standards on review engagements. The aim of this scoping document is to be able to speed up the development of an international standard by exploring many of the fundamental issues and obtaining feedback.

Closer to home this issue has also been on the agenda in ongoing discussions between Australia and New Zealand standard-setters. In this instance, our two countries are currently quite a way apart as review engagements in Australia have largely been limited to reviews of interim financial statements by the auditors of the entity. However, Australia is currently exploring the use of reviews in other contexts and as such we will continue to share information with them and work together where possible.

### Summary

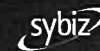
A review may be a more appropriate assurance engagement compared to an audit depending upon the specific needs of the users. They key is to clearly understand and communicate the need and the assurance of other options available.

A project to update the standards and guidance for reviews is underway in New Zealand. Additionally the area of standards and guidance for reviews is also now on the international agenda for update and further development. ■

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