

The Commissioners - Productivity Commission

PO Box 1428 Canberra City ACT 2601

6 June 2009

Dear Commissioners

Contribution of the Not for Profit Sector - Independent Examinations

Members of the Australian Not for Profit Network are particularly concerned about the inadequacy of current regulatory requirements in Australia to promote and achieve an acceptable level of financial accountability for smaller not for profit organisations.

Our attached submission highlights the shortcomings of statutory audits and the merits of independent examinations – which could well replace the audit requirement for smaller and less resourced organisations.

While most of our members are practising registered company auditors and are fully supportive of an effective auditing profession, we nevertheless recognise that, in many situations, an independent examination can provide a more cost effective alternative to an audit or reviews conducted under current Australian or International Auditing Standards. Their popularity overseas bears testimony to their acceptance among smaller not for profit organisations.

About Us: The Australian Not for Profit Network, is a network of qualified accountants and accounting firms specialising in the not for profit sector in Australia.

Members operate in all states of Australia, sharing expertise, technical training, personnel and developing resources relevant to sector.

The network aims to assist not for profit organisations in the areas of:

- financial management and financial reporting
- corporate governance
- best practice accounting standards
- operational & human resource practices

Members of the network understand the issues that affect not for profit organisations due to their personal involvement in a wide variety of NFP organisations at many levels.

Yours faithfully

Kimberly Smith, President

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AUSTRALIAN NOT FOR PROFIT NETWORK INC
SUBMISSION TO PRODUCTIVITY COMMISSION
31 MAY 2009

INDEPENDENT EXAMINATIONS – AN OPTION TO STATUTORY AUDITS

Financial Accountability

It is important that not for profit entities receiving donations and other financial support from the Australian public, or that have received grants from government bodies, should prepare a financial report consistent with transparent and accountable governance.

Acceptance of such reports by governments and the public is enhanced by independent scrutiny.

We seek in this submission to advocate the introduction into Australia of an alternative level of scrutiny, which would be relevant and cost effective to smaller not for profit organisations.

Cost/benefit of an audit

Since the introduction of 'force-of-law' international auditing standards in Australia, it has been claimed that audit costs of smaller entities represent a significant and disproportionate financial burden which would be obviated if they were not required.

A submission to the Treasury review of *Financial Reporting by Unlisted Public Companies* suggested that entities which fall 'below the threshold' should be required to produce financial reports which are not audited but for which an accountant can certify that the accounts have been kept in a manner consistent with good accounting practice and which are consistent with the needs and interests of its members¹.

In its report Review of Not for Profit Regulation, Victoria's State Services Authority stated –

Consideration of the nature of audit requirements and the range of professionals able to undertake an audit function may also provide savings. Currently, the Act² prescribes that audits must be undertaken by a registered CPA, member of the ICAA or a registered company auditor. However, Consumer Affairs Victoria could introduce independent examination as a less onerous form of scrutiny than an audit. This would extend the range of qualified accounting professionals able to provide an independent review of accounts and lower costs for NFPs. The UK Charities Commission uses such a model.

¹ Refer National Roundtable of Nonprofit Organisations submission 27 August 2007

² Victoria's *Associations Incorporation Act*

Independent Examination

In the United Kingdom, an option exists for organisations registered with the *Charity Commission* and we advocate the introduction of this type of lower-level assurance –

along similar lines to the UK model. An independent examination is not an audit and the examiner should make this clear in his or her report to the entity. An examiner should not express an opinion on the truth or fairness of the financial report, but rather provide a statement of facts.

Example of an Independent Examiner's Report

Independent examiner's statement

In the course of my examination, no matter has come to my attention:

- 1) which gives me reasonable cause to believe that in any material respect the committee of management has not met the requirements of the Act¹ to ensure that:
 - a. proper accounting records are kept; and
 - b. accounts are prepared which agree with the accounting records and comply with the accounting requirements of the Act; or
- 2) to which, in my opinion, attention should be drawn in order to enable a proper understanding of the accounts to be reached.

Independent Examination to be available in Australia

The introduction of criteria and guidance for independent examiners will provide not for profit entities in Australia with a choice similar to their counterparts in the United Kingdom.

All not for profit entities below an audit threshold³ should be able at any time to choose to have their annual financial report independently examined rather than audited.

Given the likelihood of a relaxation of statutory financial reporting and auditing obligations, our Network members believe that the option of an independent examination should be available to members and boards of entities which are not required by law to appoint an auditor.

Duties of an Independent Examiner

An independent examination involves a review of the accounting records kept by a not for profit entity and a comparison of the financial report presented with those records. It is a formal exercise, which must be properly planned, controlled and recorded. It also involves a review of the financial report and consideration of any unusual items or disclosures identified. The level of scrutiny required and the procedures undertaken in an examination do not provide the evidence

³ Threshold level for NFP audit – we recommend the same level as for for-profit entities (ie \$25m) except those entitled to tax concessions where the audit requirement should operate for entities with revenues or assets exceeding \$1million.

that would be required in a statutory audit or review in accordance with Australian Auditing Standards.

Members of our Network have been responsible for establishing the Australian Association of Independent Examiners (AAIE)⁴ which recommends that the following procedures should be followed by an independent examiner:

- a) Carry out such specific procedures as are considered necessary to provide a reasonable basis on which to conclude that the entity falls within the threshold for independent examination and that a full audit is not required.
- b) Obtain an understanding of the organisation, its accounting systems, activities and nature of its assets, liabilities, incoming resources and application of resources in order to plan the specific examination procedures appropriate to the circumstances of the entity.
- c) Record the examination procedures carried out and any matters which are important to support conclusions reached or statements provided in the examiner's report.
- d) Compare the financial report of the entity with its accounting records in sufficient detail to provide a reasonable basis on which to decide whether the financial report is in accordance with such accounting records.
- e) Review the accounting records maintained in accordance with its constitution or the legislation it is incorporated under. The purpose of this review is to provide a reasonable basis for the identification of any material failure to maintain such records.
- f) Carry out analytical procedures to identify unusual items or disclosures in the financial report. Where concerns arise from these procedures, the examiner must seek explanations from the governing board of the entity. If, after following such procedures, the examiner has reason to believe that in any respect the financial report may be materially mis-stated, then additional procedures, including verification of the asset, liability, incoming resource or application of resources, must be carried out.
- g) Carry out such detailed procedures as the examiner considers necessary to provide a reasonable basis on which to decide whether or not the financial report complies with Australian GAAP (Generally Accepted Accounting Principles) which should apply to entities of this type⁵.
- h) Review and assess all conclusions drawn from the evidence obtained from the examination and consider the implications on the report to be made. If the examiner has cause to make a statement on any matter, then the examiner must ensure so far as practicable that the report so made gives a clear explanation of the matter and of its financial effects on the financial report presented.
- i) Issue a report to the members of the entity, which must be attached to the financial report whenever it is distributed or otherwise made available.

Who could be an independent examiner?

An independent examiner is an independent person who is reasonably believed by the governing board to have the requisite ability and practical experience to carry out a competent examination of the financial report. The term 'independent examiner' does not exclude an accountant or, indeed, a registered company auditor, but recognises that the scrutiny is less onerous than an assignment in accordance with Australian Auditing Standards.

⁴ Australian Association of Independent Examiners ABN 84 114 146 719

⁵ The obligation for many small NFP entities to comply with the financial reporting requirements of Australian (International) Financial Reporting Standards (IFRS) has the potential to mislead and confuse the users of their financial reports.

What does 'independent' mean?

For an examiner to be independent, that individual must have no connection with the entity which might appear to be prejudicial to an impartial examination of the financial report.

The following persons will normally be considered to have a connection with the entity that makes it inappropriate for them to be an examiner:

- (a) a member of the entity or any of its sub-committees;
- (b) an employee of the entity, or a person receiving benefit or support from entity funds by way of a gift (other than a fee received as an examiner);
- (c) a close relative, business partner or employee of any person who falls within sub-paragraph (a) or (b) above.

Note: An independent examiner may, however, be an adherent or member of a church or similar community, provided they are not involved in its leadership or management.

What sort of people can be appointed an independent examiner?

In the opinion of our Network, for smaller entities with gross income and total expenditure of less than \$50,000 which do not raise funds from the public, a financial report prepared on the Receipts and Payments basis (cash basis), it may be appropriate to use anyone with basic bookkeeping skills to examine the financial report. For entities with a gross income up to \$200,000 an appropriate independent examiner would be someone more familiar with business and financial matters, but they need not be a qualified accountant. Entities with gross income or assets exceeding \$200,000, or who choose to prepare accrual based financial reports, should consider selecting a qualified accountant to carry out the independent examination.

While a qualified accountant holding a practising certificate from a professional body is recommended for larger entities (ie. \$1m+), examples of those who may be suitable for smaller entities may include non-practising members of the professional bodies or accounting and commerce graduates from Australian universities.

Recommendations

We recommend –

- (1) That the governing bodies of all not for profit entities in Australia be entitled to appoint an independent examiner instead of an auditor.
- (2) That a national regulator be established specifically to regulate the not for profit sector in Australia and to provide a statutory incorporation framework which takes into account the needs of that sector; or
- (3) That, failing the establishment of a national regulator, the Corporations Act be amended to extend the status of a 'special purpose company'⁶ to all not for profit entities in Australia and enable NFP companies limited by guarantee and incorporated associations to migrate to that status to achieve relief from the more onerous financial reporting obligations which apply to for-profit entities in Australia; and

end of submission

⁶ Special Purpose Company – refer www.asic.gov.au/asic/asic.nsf/byheadline/Special+purpose+companies?openDocument