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Auditing Guidance Statement

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Auditing Revenue of Charitable Entities

Prepared by the **Auditing & Assurance Standards Board** of the
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AUDITING GUIDANCE STATEMENT
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Introduction

- .01 Auditing Standards (AUSs) contain the basic principles and essential procedures together with related guidance that apply to the audit of the financial report of any entity, including a charitable entity, irrespective of their size, legal form, or the nature of their activities. However, the Auditing & Assurance Standards Board (AuASB) recognises that the audit of charitable entities gives rise to a number of specific audit issues, a significant one of which is forming a conclusion about the completeness assertion in relation to revenue from voluntary sources such as donations, other fundraising activities and other forms of contributions.
- .02 From an audit perspective, there can often be uncertainty about whether a charitable entity has obtained all voluntary revenue to which it has a right to receive from its respective fundraising or other revenue generating activities. Consequently, an auditor may find it difficult to perform the tests of control and substantive procedures that are necessary to reduce audit risk, particularly in respect of the completeness of voluntary revenue, to an acceptable level. When such a scope limitation exists, the auditor considers expressing a qualified opinion. However, the expression of a qualified opinion in respect of the completeness of voluntary revenue ought not to occur as a matter of course for all charitable entities that receive voluntary revenue.
- .03 The purpose of this Auditing Guidance Statement (AGS) is to provide guidance to auditors on the factors to consider when determining whether sufficient appropriate audit evidence can be obtained to provide an objective basis for forming an opinion about the completeness of revenue. This AGS also contains an Appendix which outlines various audit risks associated with different sources of voluntary revenue and indicative audit procedures that may be adopted for the audit of each source of voluntary revenue.
- .04 The nature and extent of the guidance provided in this AGS is applicable to all audits of charitable entities and is designed to assist the auditor in exercising professional judgement in the application of AUSs. The guidance provided may also assist in the audit of other not-for-profit entities. The AGS does not provide detailed guidance of a procedural nature, as this may undermine the proper exercise of professional judgement in auditing.

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Characteristics of Charitable Entities

- .05 For charitable entities, significant diversity can exist in their activities and operations, size, and legal structures. There is also significant public interest in the accountability of charities, because for example, they are supported by voluntary contributions of both physical and financial resources and their purpose is largely to serve some public need, as opposed to being in business for profit. To varying degrees, such characteristics impact on the audit of charitable entities, including the audit of voluntary revenue.

Regulatory Framework Affecting Charitable Entities

- .06 Auditing Standard AUS 202 “Objective and General Principles Governing an Audit of a Financial Report” paragraph .07 states: ***“The procedures required to conduct an audit in accordance with AUSs should be determined by the auditor having regard to the requirements of AUSs, legislation, regulations and, when appropriate, the terms of the audit engagement and reporting requirements.”***
- .07 The regulatory framework for charitable entities can be complex. Charitable entities may operate under a variety of legal structures, such as a company limited by guarantee, a trust, an incorporated or unincorporated association, Royal Charter or pursuant to legislation enacted specifically to establish the charitable entity. Each of the above legal structures may impose specific financial reporting and auditing requirements. A charitable entity’s governing documents may prescribe specific disclosure requirements to be made in its financial report or other responsibilities which impact on the scope of the audit. The legal structure may also affect the financial reporting framework, for example, the extent to which compliance with Accounting Standards is required.
- .08 The conduct of some activities undertaken by charitable entities, for example, major fundraising events or other activities associated therewith, may be governed by specific regulations. Such regulations may prescribe compliance and reporting obligations by the entity’s governing body and the auditor in connection with the particular event. Any material non-compliance with these regulations could have a significant financial impact should any limitation be placed on the charitable entity undertaking similar activities in the future.

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Nature of Voluntary Revenue

- .09 The revenue of charitable entities may be derived from a variety of sources, such as voluntary cash donations from members of the public, donated materials, and restricted and unrestricted grants from government. Voluntary revenue may be obtained from street, door-to-door or postal collections, special events or other methods of fundraising. Voluntary revenue from fundraising activities can be geographically dispersed, and may be directed to a charitable entity from professional or voluntary fundraisers. However, unlike revenue of business entities, the collection of such revenue may not be supported by invoices or equivalent documentation, or subject to internal controls commonly found in business entities. In contrast to business entities, charitable entities earn their voluntary revenue from persons who do not receive or expect to receive a direct benefit in exchange. Consequently, from an audit perspective the control systems usually found in a business environment may not be present for some sources of voluntary revenue.
- .10 It can sometimes be difficult to accurately estimate the level of revenue from donations, contributions or grants. This is because for example:
- (a) donors’ patterns of giving may change, due for example, to economic hardship or competing demands on limited resources; and
 - (b) some contributions, such as grants to undertake particular activities being dependent on a tendering process. Such funding decisions are usually based on considerations by third parties over whom the charitable entity has little influence. Receipt of these funds can be for a specific purpose, with their use subject to compliance with specific conditions.
- .11 It may be difficult to establish a relationship between donations and other amounts in the financial report, as expenditure levels may not have any direct relationship with such revenue.

Internal Control

- .12 It is important that the governing body of a charitable entity maintains an effective internal control structure over their activities. The governing body has responsibility for ensuring that all voluntary and other revenues to which the charitable entity gains control are accounted for properly. This involves establishing controls to ensure that voluntary revenue is recorded correctly in the financial records

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of the charity, and that the revenue recognised in the financial report is in accordance with Accounting Standards and the entity’s accounting policies adopted for revenue recognition. Many aspects of a charity’s control environment and individual control procedures will be the same as those of a business entity. However, the internal control structures for charitable entities are likely to be affected, to varying degrees, by the following factors:

- (a) limited resources being available to achieve internal control objectives, because generally charitable entities keep administrative staff and management tools to a minimum so that resources are allocated to activities that will help it achieve its mission;
- (b) the likelihood that volunteers will be involved in the charitable entity. The involvement of volunteers can range from serving in a voluntary capacity on the charitable entity’s governing board to daily involvement in the entity’s operations or management, including performing accounting functions and fundraising;
- (c) the culture that underlies various facets of the control environment, including attitudes towards the importance of accountability, how authority and responsibility are assigned, and personnel management policies and practices;
- (d) the existence of any externally imposed requirements by contributors, or national or international bodies affiliated with the charitable entity who may require certain control procedures be implemented, such as ensuring that certain expenses are approved by the governing body;
- (e) the regulatory requirements relating to its fundraising activities;
- (f) the existence of accountability requirements over operations in the form of key performance indicators, for example the ratio of organisational and fundraising expenditure to revenue, or cost of fundraising to funds raised; and
- (g) where specialist fundraisers or other non-controlled entities undertake fundraising on behalf of a charitable entity, there may be difficulties in establishing whether the entity receives all the revenue over which it is perceived to have gained control.

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The Audit of Voluntary Revenue

Audit Strategy

- .13 In forming an opinion on management’s assertions about whether voluntary revenue is properly stated the auditor develops an audit strategy based on an assessment of:
- (a) inherent risk and control risk – in accordance with Auditing Standard AUS 402 “Risk Assessments and Internal Controls”. For the audit of voluntary revenue, as well as other material account balances or class of transactions, the auditor assesses inherent risk and obtains an understanding of the internal control structure to assess audit risk, and to determine whether the evaluation and testing of controls and the application of substantive tests will reduce audit risk to an acceptably low level with respect to the assertions about the completeness and recording of voluntary revenue; and
 - (b) the materiality of voluntary revenue – in accordance with Auditing Standard AUS 306 “Materiality and Audit Adjustments”, and the discussion of materiality in Accounting Standards AASB 1031/AAS 5 “Materiality and Audit Adjustments” and Accounting Standards AASB 1001/AAS 6 “Accounting Policies”. In determining the materiality of voluntary revenue, qualitative materiality considerations may be significant, given the characteristics of charitable entities, and the nature of and sources from which voluntary revenue is derived. For example, public awareness or perception of any misappropriation of funds donated to a charity, due to lack of controls over the collection or recording of donations, or misuse of funds by a charitable entity, even if of a seemingly immaterial amount, may nonetheless result in a breach of donors’ trust, and possibly result in their decision not to make further donations to a particular charity. Such events may severely damage the public reputation of the entity, and its ability to undertake current and future operations.

Completeness of Voluntary Revenue

- .14 Auditing Standard AUS 502 “Audit Evidence” states that generally audit evidence is obtained regarding each financial report assertion. Sufficient appropriate audit evidence needs to be obtained to provide a basis on which to conclude whether the voluntary revenue included in a charitable entity’s financial report is, in all material

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respects, complete. In some cases there may be a significant audit risk that voluntary revenue may not be recorded, and consequently materially understated (“incomplete”).

- .15 It is sometimes not possible for the auditor to obtain reasonable assurance about whether voluntary revenue from all sources to which a charitable entity is entitled is received and recorded by the entity. However, as the revenue of each charitable entity may be derived from, and obtained by, different sources and methods, each source has its own distinct inherent and control risk. In assessing whether voluntary revenue is properly stated the auditor’s considerations may include an assessment of the:
- (a) nature of the various sources of voluntary revenue received by the charitable entity, the risks associated with their method of receipt, including any specific risks in the context of the entity’s activities;
 - (b) effectiveness of the controls that are applied, given that some controls can usually be established for each source of voluntary revenue, they in turn may assist in evaluating when an entity gains control of its revenue for the purposes of recognising revenue in its financial statements; and
 - (c) materiality of each source of voluntary revenue in relation to all of the charitable entity’s revenue.

Appendix 1 to this AGS sets out, for illustrative purposes only, the risks associated with various sources of voluntary revenue, the controls which a charitable entity may implement in respect of those revenues, and some indicative audit procedures which the auditor may consider in relation to the audit of each source of voluntary revenue.

Audit Reporting

- .16 Where the auditor obtains sufficient appropriate audit evidence to conclude that voluntary revenue reported in a charitable entity’s financial report is, in all material respects, presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements, the auditor issues an unqualified audit report on these grounds. This may be the case where for example, a charitable entity receives most of its voluntary revenue in the form of grants, contributions or fees, and only an immaterial amount from cash donations and other fundraising. In this instance, audit evidence in relation to the completeness of revenues received from these sources, is likely to provide sufficient

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appropriate audit evidence that revenue is, in all material respects, presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements.

- .17 However, a charitable entity may have a material proportion of its voluntary revenue from sources for which there are limited controls, as it may be impracticable to maintain effective controls prior to the recording of voluntary revenue in the financial records. Accordingly, it may not be possible to obtain reasonable assurance about the completeness of voluntary revenue from these sources. In the absence of other evidence, and where voluntary revenue is material, the scope of the auditor’s work is limited in so far as being able to obtain sufficient appropriate audit evidence to conclude whether the financial records reflect voluntary revenue from the point at which the charitable entity gained control. Therefore, in accordance with AUS 502.18 “Audit Evidence”, where substantial doubt remains as to a material financial report assertion, such as the completeness of revenue, and the auditor has been unable to obtain sufficient appropriate audit evidence, “...*a scope limitation exists, and the auditor should, in accordance with AUS 702 ‘The Audit Report on a General Purpose Financial Report’, express a qualified opinion*”.
- .18 AUS 702 “The Audit Report on a General Purpose Financial Report”, requires an “except for” opinion to be expressed if the scope limitation is material but not extreme. In situations where the scope limitation is extreme the auditor will need to express in the audit report an “inability to form an opinion”. Further guidance is provided in AUS 702.53 to .56. The wording of the auditor’s report indicates that the auditor’s opinion “...*is qualified as to the effects on the financial report of such adjustments, if any, as might have been required had the limitation not existed*” (AUS 702.56). An example of a qualified audit report is included in Appendix 2 to this AGS.

Operative Date

- .19 This AGS, which incorporates amendments made by AUS/AGS Omnibus 3 “Miscellaneous Amendments to AUSs and AGSs”, is operative from July 2002. This version of AGS 1054 supersedes AGS 1054 “Auditing Revenue of Charitable Entities”, as revised in February 1999.

Compatibility with International Standards and Statements on Auditing

- .20 There is no corresponding International Standard or Statement on Auditing.

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APPENDIX 1

EXAMPLE CONTROLS AND AUDIT PROCEDURES RELATING TO VOLUNTARY REVENUE

While this Appendix contains certain example internal controls and indicative audit procedures, it does not describe all of the internal controls or procedures necessary to establish control over voluntary revenue or perform an audit of a charitable entity’s voluntary revenue in accordance with Australian Auditing Standards. The guidance in this Appendix is neither intended to be comprehensive, nor is it intended to limit or supplant individual professional judgement. Audit programs and audit procedures for each audit need to be designed to meet the requirements of the particular engagement, which is a matter that can be determined only by the exercise of professional judgement in the light of the circumstances present in a particular case.

The example controls listed below for voluntary revenue assist in improving control over the collection of these sources of voluntary revenue. However, overall control of voluntary revenue is enhanced if the governing body implements policies governing the undertaking of fundraising activities, establishes operational and financial internal controls for fundraising and has in place procedures to ensure compliance therewith.

Voluntary Revenue & Risks	Methods of Collection	Example Controls	Indicative Audit Procedures
Cash donations <ul style="list-style-type: none"> • Inherent risk high, as cash donations are highly susceptible to inadvertent misplacement, or loss through fraud or theft • Control risk associated with the completeness of cash donations cannot usually be assessed as low 	<ul style="list-style-type: none"> • Direct cash donations (e.g. door-to-door or street collection, or small special events) 	<ul style="list-style-type: none"> • Establish numerical control over collection boxes • Ensure appropriate sealing of collection boxes so that any opening prior to recording cash is apparent • Maintain regular collection and recording of proceeds from collection boxes • Establish dual control over counting and recording of proceeds 	<ul style="list-style-type: none"> • Review and test procedures implemented to collect cash donations and their systems of control • Review and test policies and procedures followed by staff or volunteers when collecting cash donations

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Voluntary Revenue & Risks	Methods of Collection	Example Controls	Indicative Audit Procedures
		<ul style="list-style-type: none"> • Issue receipts, where appropriate • Require collectors to operate in pairs so that one collector is able to observe the actions of the other • Where collections are solicited from a designated geographical area, require a report on the response of each collection unit (e.g. each household) 	<ul style="list-style-type: none"> • Design analytical procedures for each different source or geographical area from which cash donations are obtained, e.g. compare cash donations from a particular activity or geographical area with previous years or budgeted cash donations
	<ul style="list-style-type: none"> • Postal cash donations e.g. received from a fundraising appeal 	<ul style="list-style-type: none"> • Segregate mailing opening and bank deposit functions • Ensure immediate recording of donations on opening of mail or receipt • Agree bank paying-in slips with a record of receipts by an independent person 	<ul style="list-style-type: none"> • Observe control procedures • Analyse donations received to donations requested, and compare with previous years or industry statistics (if available)

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Voluntary Revenue & Risks	Methods of Collection	Example Controls	Indicative Audit Procedures
<p>Fundraising campaigns and other special events</p> <ul style="list-style-type: none"> Given the range and size of specific fundraising events that charitable entities may undertake, each event will have its own inherent and control risk, though like cash donations, audit risk in respect of the completeness of voluntary revenue from these sources is usually high 	<ul style="list-style-type: none"> Telemarketing campaigns Bingos, raffles and lotteries Social events Large appeals 	<ul style="list-style-type: none"> Establish procedures to ensure compliance with any regulatory requirements that pertain specifically to the fundraising event Ensure persons responsible for handling collections from ticket sales account for each prenumbered ticket sold, and provides a reconciliation to tickets issued for sale Independent person to reconcile tickets issued against tickets sold or returned unsold, with the person being segregated from the person responsible for counting and depositing monies received 	<ul style="list-style-type: none"> Review compliance with any regulations that are applicable to the fundraising event To determine completeness of revenue recorded from social events, assess the reasonableness of related expenditure, compare amounts recorded with past revenue and expenditure for the event For each material fundraising event, review procedures adopted by the charitable entity for capturing and recording voluntary revenue to which it controls

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Voluntary Revenue & Risks	Methods of Collection	Example Controls	Indicative Audit Procedures
<p>Donated materials</p> <ul style="list-style-type: none"> • Inherent risk in estimating the fair value of donated materials • Lack of evidence as to existence due to possible prior use 		<ul style="list-style-type: none"> • Develop policies to ensure immediate recording of donated materials, with periodic review of policies by the appropriate level of management • Segregate incompatible tasks, such as between responsibility for receipt of donated materials and recording • Supervise collections to prevent collusion or theft 	<ul style="list-style-type: none"> • Enquire about the accounting policies adopted for recording donated materials, test the extent and effectiveness of the accounting procedures and internal controls • Compare data collected on current year donated materials with budgeted material contributions or previous years • Consider confirming contributions from significant donors
<p>Bequests and Legacies</p> <ul style="list-style-type: none"> • Potential for breach of restrictions (if any) regarding the use of a bequest or legacy through inadequate implementation of accounting controls 		<ul style="list-style-type: none"> • Maintain comprehensive correspondence files for each bequest or legacy received or receivable • Implement systematic procedures to detect if any restrictions are imposed on the expenditure of funds, and ensure details about restrictions are communicated to those responsible for expenditure of funds 	<ul style="list-style-type: none"> • Review correspondence relating to bequests and legacies, noting the imposition of any restrictions and the consequences of non-compliance therewith

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Voluntary Revenue & Risks	Methods of Collection	Example Controls	Indicative Audit Procedures
<p>Pledges</p> <ul style="list-style-type: none"> Inherent risk associated with estimation of the realisable value of pledges receivable is particularly significant 	<ul style="list-style-type: none"> Solicited from regular or special fundraising campaigns and can be made by telephone, other electronic devices or in writing 	<ul style="list-style-type: none"> Separately record legacies with restrictions imposed and deposit in trust or separate bank account Establish a method of recording and maintaining control over pledges when obtained, including procedures to ensure detection of, and compliance with, restrictions or conditions (if any) Establish a collections policy for pledges, for the purposes of providing for uncollectible pledges 	<ul style="list-style-type: none"> Review procedures for recording bequests and legacies Review and test the process used by management to estimate pledges receivable Review the aging of pledges Consider obtaining confirmation of unusual or significant pledges Compare pledges receivable with subsequent receipt of donations Determine whether the materialisation ratios used to estimate pledges receivable is reasonable
<p>Contributions from grants or restricted income</p> <ul style="list-style-type: none"> Potential for breach of the conditions or restrictions on the use of the grant 	<ul style="list-style-type: none"> Contributions from government possibly following from tendering process Receipt from major donors or supporters 	<ul style="list-style-type: none"> Maintain comprehensive records of applications made and implement follow-up procedures for grant applications not discharged 	<ul style="list-style-type: none"> For evidence on the completeness assertion, examine grant applications and correspondence Confirm grants receivable

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APPENDIX 2

EXAMPLE OF A QUALIFIED AUDIT REPORT (SCOPE LIMITATION) FOR A CHARITABLE ENTITY

For charitable entities that derive a material proportion of their revenue from sources for which either there does not exist, or it is impracticable to maintain, controls over the collection of such revenue, prior to its initial entry into the financial records, the audit evidence available in respect of the completeness assertion will be limited. Accordingly, where such circumstances exist, a qualified audit report may be issued. The following audit report is provided as an example of the form which it may take.

INDEPENDENT AUDIT REPORT

To [addressee]

Scope

We have audited the financial report of [name of charitable entity] for the year ended 30 June [year] as set out on pages X to Y¹. The [members of the governing body] are responsible for the financial report. We have conducted an independent audit of the financial report in order to express an opinion on it to [addressee].

Our audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial report is free of material misstatement. Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial report, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion whether, in all material respects, the financial report is presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements [and relevant statutory and other requirements] so as to present a view which is consistent with our understanding of the [charitable entity’s name] financial position, the results of its operations and its cash flows.

The audit opinion expressed in this report has been formed on the above basis.

¹ or identify the individual components when appropriate.

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Qualification

[Identify source(s) of voluntary revenue] are a significant source of revenue for the [name of charitable entity]. The [name of charitable entity] has determined that it is impracticable to establish control over the collection of [identify source(s) of voluntary revenue] prior to entry into its financial records. Accordingly, as the evidence available to us regarding revenue from this source was limited, our audit procedures with respect to [identify source(s) of voluntary revenue] had to be restricted to the amounts recorded in the financial records. We therefore are unable to express an opinion whether [identify source(s) of voluntary revenue] the [name of charitable entity] obtained are complete.

Example Qualification Paragraph for Cash Donations

Cash donations are a significant source of revenue for the XYZ Society. The XYZ Society has determined that it is impracticable to establish control over the collection of cash donations prior to entry into its financial records. Accordingly, as the evidence available to us regarding revenue from this source was limited, our audit procedures with respect to cash donations had to be restricted to the amounts recorded in the financial records. We therefore are unable to express an opinion whether cash donations the XYZ Society obtained are complete.

Qualified Audit Opinion

In our opinion, except for the effects on the financial report of such adjustments, if any, as might have been required had the limitation on our audit procedures referred to in the qualification paragraph not existed, the financial report presents fairly in accordance with applicable Accounting Standards and other mandatory professional reporting requirements (and...²) the financial position of [name of charitable entity] as at 30 June [year] and the results of its operations and its cash flows for the year then ended.

² cite relevant statutory and other requirements when appropriate.

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APPENDIX 3

AUDIT OF VOLUNTARY REVENUE AND TYPES OF AUDIT OPINIONS

