



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **10.0**
Meeting Date: 12-13 June 2019
Subject: Not-For-Profit Sector Auditing and Assurance Issues
Date Prepared: 28 May 2019

Action Required

For Information Purposes Only

Agenda Item Objectives

1. The objectives of this paper are to:
 - (a) inform the AUASB of the activities undertaken by the AUASB Technical Group (ATG) to assist the Financial Reporting Council (FRC) with understanding, assessing and improving audit quality in the not-for-profit private sector; and
 - (b) seek AUASB feedback on whether any of the matters identified through the research impact on the AUASB and what actions, if any, should be taken by the AUASB.

Background

2. In October 2018, a research report was presented to the AUASB by Jenny (Yitang) Yang an academic from UNSW. The report summarised key findings from the academic's research¹ regarding audits of large charities registered with the Australian Charities and Not-for-profits Commission (ACNC) including, auditor selection, financial reporting framework choice, auditor remuneration and auditor's opinions. The research also looked at assurance choices of medium charities.
3. In April 2019, the ATG hosted a session at which the academic who conducted the research presented their results to a group of relevant stakeholders which included the ACNC, Australian Accounting Standards Board (AASB) Staff, ATG, CPA Australia and CA ANZ.
4. The aim of the session was to discuss the implications of the research for the profession, to understand and assess possible indicators of audit quality in the NFP sector and determine appropriate actions to improve quality. The initial outcomes of the discussion were presented to the FRC at the May 2019 FRC Meeting and was intended to form part of the FRC's systematic review of audit quality in Australia.

¹ Yang, Y. 2018, The Informational Value of Auditing, PhD dissertation, UNSW Sydney.

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5. The paper presented to the FRC focussed on the audit quality implications of the research and how the research could assist the FRC with their mandate for audit quality under Part 12 the *Australian Securities and Investments Commission Act 2001*. Whilst broader audit quality implications are an important part of the AUASB's understanding of the assurance environment, this paper, **Agenda Item 9**, has been prepared for the AUASB with a focus on seeking feedback as to whether there are any direct implications for the standards and other pronouncements of the AUASB from the research.

Matters to Consider

6. This section of the paper is structured to give the AUASB:
 - (a) a high level view of the key issues; and
 - (b) an ATG recommendation for AUASB action related to each issue.
7. Attachment 1 provides more detail regarding each of the issues identified including supporting data from the research.

Key Findings from the Research

Who audits charities?

8. 30% of all audits of large charities are conducted by the top 10 audit firms (by size). The remaining 70% of large charity audits are conducted by approximately 1,000 different auditors, of those 1,000 auditors greater than 50% of them are located in non-metropolitan areas.
9. Based on the last ASIC Audit Inspections Report, 6 files of smaller firms were reviewed in the 18 months to 30 June 2018. Anecdotally the error rate amongst those smaller files reviewed was significantly higher than the largest six and other national and network firms. This highlights the importance of the professional accounting bodies' auditor inspections and educative process in this sector.

ATG Action

1. The ATG will use the auditor information to expand the database of auditors to ensure that the work the AUASB is doing is being communicated to all relevant stakeholders. No action for the AUASB.

Observations from Auditor's Reports

10. The research identified errors and non-compliance with the auditing standard on auditor reporting. This included errors in the identification of the financial reporting framework and in the reporting of modified auditor's opinions.
11. This may be an indication of underlying issues with audit quality, in particular, auditors not staying up-to-date with current requirements. This is supported by the research which identified 30 'subject-to' audit opinions which predate the current suite of AUASB standards.
12. The research also showed that there was significantly lower number of modifications and EOMs related to going concern than in the for-profit sector. This will require further investigation as to why and aligns with work being done on going concern for the public sector.

ATG Action

2. Action related to identification of the financial reporting framework aligns with AUASB action in **Agenda Item 10**. The ATG is recommending issuing a bulletin to remind auditors of the requirement to evaluate whether the financial report adequately describes the financial reporting framework ATG and the additional requirements under ASA 800 where the financial report is a special purpose financial report.
3. With regards to going concern, the ATG will determine an appropriate action based on the outcomes of the Public Sector project as the factors related to going-concern issues are similar (withdrawn funding from government etc.). In the interim, the ATG will review the templates on the ACNC website and determine whether modified auditor's report templates are required.

Audit versus Review

13. The research showed that 92% of charities who can elect to have their financial report either audited or reviewed, chose to have their financial report audited.
14. Whilst this does not raise any immediate concerns relating to audit quality, we are unsure why the occurrence of reviews is so low. Further work will be required to determine whether this is due to a lack of understanding of this option or other factors.

ATG Action

4. No immediate action for the ATG.

Questions

1. Does the AUASB agree with actions 1-4 outlined by the ATG?
2. Are there any other actions that the AUASB consider appropriate based on the research?
3. Does the AUASB consider further research is require in any of the particular areas identified, or related areas not covered by this summary?

Material Presented

Agenda Item 10

BMSP NFP Auditing and Assurance Issues

Action Required

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Review and provide feedback		AUASB	12-13 June 2019	

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Attachment 1 – Key Findings from Research

Note: The information in this attachment is not to be cited without the permission of the author.

The Auditors

A key insight from the research for the Working Group (ACNC, ATG, AASB, CPA and CA ANZ) was developing a better understanding of the assurance practitioners in this sector. Importantly, in the large charity auditor population there were approximately 1,113 different auditors, however as Table 1 shows below, 30% of all engagements were done by one of the top 10 audit firms in Australia.

Table 1 - Audits completed by the Top 10 firms in Australia.

	Entire		2015		2014	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Big 4	1,036	13.53%	547	13.53%	489	13.56%
Next 6	1,389	18.15%	722	17.84%	667	18.49%
Sub-total Top 10	2,425	31.68%	1,269	31.37%	1,156	32.05%

The population of auditors was further broken down into metropolitan and non-metropolitan auditors determined using postcode information. Approximately 644 (58%) of the 1,113 auditors were considered non-metropolitan. However, whilst non-metropolitan auditors accounted for 58% of the population of large charity audits they only accounted for approximately 34% of the audits.

The information about the population of auditors and who was undertaking the engagements led to a discussion by the Working Group about issues related to the viability of the profession in the future, in particular, in the context of the declining RCA numbers and the increasing complexity of the standards. The database of auditors is to be shared with all Working Group members to assist with future engagement.

The database of auditors is particularly useful for the AUASB to assist with collecting robust Australian feedback to respond to the [IAASB's Less Complex Entities Discussion Paper](#) released in late April 2019.

The Working Group discussion around the future viability of the profession was largely focussed on the qualifications of assurance practitioners in this area. The Accounting Professional Bodies raised, in the context of declining RCA numbers, whether a new qualification level below RCA could be introduced to assist with accessibility of competent auditors. It was noted however that this would require legislative change as the ACNC Act requires an RCA and would be considered when legislative changes resulting from the ACNC legislative review occur.

Auditor's Reports

The research provided insights for the Working Group on:

- The number of errors in large charity auditor's reports; and
- The frequency and types of modifications being made to large charity auditor's reports.

Errors in Auditor's Reports

The research highlighted the prevalence of auditor reporting errors related to financial reporting framework choices, in particular, that a Special Purpose Financial Report (SPFR) had been prepared and the auditor's

report had failed to alert the reader to the fact that a special purpose framework had been used, which is a requirement of the auditing standards.²

Table 2 below shows that of the 3,202 SPFR identified from the data, 12% of them did not meet the requirement of ASA 800 to draw the reader’s attention to the framework. This was largely an issue with entities outside the top 10 largest audit providers (the top 10 had an error rate of less than 1%).

The table also shows that 289 preparers did not appropriately disclose the financial reporting framework as required by accounting standards³. These findings are in-line with AASB research which shows the lack of appropriate disclosure of SPFR. The fact that the preparers did not appropriately disclose the financial reporting framework means that the auditor has also not met the requirements of the auditing standards to evaluate whether the financial report adequately describes the financial reporting framework⁴.

Table 2 – Description of Financial Reporting Frameworks.

Framework	Described in Financials		Described in Auditor’s Opinion		Difference	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
SPFS	3,202	41.93%	2,852	41.42%	(350)	(12%)
GPFS	4,146	54.29%	N/A	N/A	N/A	N/A
Not disclosed	289	3.78%	N/A	N/A	N/A	N/A
Total	7,637	100%	7,637	100%		

Further to the basic auditor reporting errors it was found that 30 ‘subject-to’ auditor opinions were issued by 17 different large charity auditors. ‘Subject-to’ opinions have not been part of the assurance framework for many years and predate the current suite of AUASB standards. This may be indicative of the competence of some of the audit practitioners who work in this space and their lack of effort to stay up-to-date. A sample of the financial reports which had a ‘subject-to’ opinion were reviewed and on average these charities had greater than \$1.5m annual income.

The higher error rate amongst auditors outside the top 10 and the occurrence of ‘subject-to’ opinions was discussed by the Working Group. The immediate actions are to contact the auditors who issued the ‘subject-to’ opinions and to work with the ACNC and the professional accounting bodies to communicate to auditors that changes to the format of the auditor’s report were effective for financial reporting periods ended on or after 15 December 2016 and that templates and other supporting materials are available.

There is also a need to communicate to auditors the impact of the AASB’s proposed changes as part of their Financial Reporting Frameworks project which will require entities preparing SPFR to make an explicitly statement that they have complied with recognition and measurement requirements and therefore requires the auditor to sign off on whether the entity has met those requirement.

Modifications to Auditor’s Reports

As outlined in **Table 3** below, the most common reasons for a modified auditor’s report were:

- A limitation of scope due to the internal controls over cash donations and fundraising revenue; and
- Going concern either due to financial dependency or current financial situation (283 were unqualified opinions).

² See, ASA 800 *Special Considerations-Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks* paragraph 14.

³ See, AASB 101 *Presentation of Financial Statements* and AASB 1054 *Australian Additional Disclosures*.

⁴ See ASA 700 *Forming an Opinion and Reporting on a Financial Report*.

Table 3 - Modifications to the Auditor's Report

Modification (including EOM)	Frequency	Percentage
Limitation of scope (mostly related to controls over cash)	780	57.44%
Going Concern (Financial dependency)	214	15.76%
Matters relating to the electronic presentation of FR	168	12.37%
Going Concern (Current financial situation)	139	10.24%
Significant Uncertainty over comparatives (opening bal.)	90	6.36%
Material Misstatement due to departure from Australian Accounting Standards	58	4.27%
Total modified opinions including EOM	1,358	

Further work will be required to understand the modifications. The AUASB has on issue guidance statements that relate to the first and third modification reasons, GS 006 *Electronic Publication of the Auditor's Report* and GS 019 *Auditing Fundraising Revenue of Not-for-Profit Entities*. As part of the AUASB's current review of its suite of guidance statements work will be undertaken to understand whether there is a lack of awareness or deficiencies of those guidance statements.

The modifications research also provided some insight into possible accounting issues. As shown in **Table 3**, 58 opinions were modified due to non-compliance with Australian Accounting Standards (AAS). 52 of the modifications were for departures from a single AAS, 5 were for departures from multiple AAS and 1 was for not adopting AASs at all.

Table 4 below shows that the most frequent departure from AAS related to inappropriate depreciation methods being chose and inappropriate disclosure of comparatives.

Table 4 - Departure from Australian Accounting Standards

Material Misstatement due to departure from Australian Accounting Standards	Frequency	Percentage	Most Common Reason
AASB 116 <i>Property Plant and Equipment</i>	15	23%	Inappropriate depreciation method
AASB 101 <i>Presentation of Financial Statements</i>	10	16%	Disclosure of comparatives
AASB 1004 <i>Contributions</i>	8	13%	Treatment of grants
AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	7	11%	Disclosure of leave provisions

The research also highlighted the significantly lower number of modifications to auditor's report of charities as a result of going-concern (qualifications and EOMs⁵) compared to for-profit entities. Research showed that in 2015, 34.73% of listed-entities auditor's reports had going concern related language (qualifications and EOMs) compared to 4.61% of large charities for the same period.⁶

The low prevalence of the going concern modifications in the charity population was not able to be clearly explained and further investigation is required by the Working Group. Regression analysis using the large charity data showed that the greater a charities' reliance on government grants, the higher the possibility of

⁵ Where a material uncertainty exists over an entity's ability to continue as a going concern and management's disclosure of the material uncertainty is adequate, the auditor's report is unqualified but modified to include an Emphasis of Matter drawing the reader's attention to management's assessment of going concern.

⁶ *Audit Reports in Australia 2005 – 2015: An updated analysis*, Carson et al, 2017

having going concern related language in the auditor’s report. **Table 5** shows that close to 50% of all large charities have a significant reliance on government grants.

Table 5 - Reliance on government grants

Government Grants	Frequency	Percentage
Charity has government grants which account for more than 50% of their total income	3,592	47%
Charity relies entirely on government grants	155	2%

Audit versus Review for medium charities

The research shows that that overall only 8% of medium charities chose to have their financial statements reviewed. As outlined earlier in the paper, medium charities are able to choose to have their financial report audited or reviewed under the ACNC legislation.

The review option was included in the legislation to be a ‘cheaper’ assurance option for medium charities to reduce the red-tape burden. The low number of medium charities choosing a review over an audit has been discussed previously by the ACNC, AUASB and the Professional Accounting Bodies as a key issue to address in this sector.

A new insight from the research was 31% of all Big 4 medium charity engagements were reviews, whilst only 6% of non-Big 4 medium engagements were reviews. Refer to **Table 6**.

Table 6 - Medium charity averages

Medium Charity Averages	Big 4		Non-Big 4	
	Audit	Review	Audit	Review
All	288 (69%)	129 (31%)	5,291 (94%)	354 (6%)
Total assets	4,166,531	5,617,744	1,607,878	2,134,046
Total liabilities	269,030	23,846	287,784	161,081
Total income	656,924	396,663	640,571	532,706
Total expenses	613,640	269,844	587,760	455,750
Fees (\$)	5,337	2,372	4,232	3,279

The reasons for this were discussed by the Working Group. One possible reason was that Big 4 are the most comfortable with the review standards and have a robust review methodology to support limited assurance engagements. The low number of review engagements also could be possibly linked with grant acquittal requirements. A large number of grants require an audit. For example, a government entity in NSW requires an audit for all grants over \$20,000 as well as an additional agreed-upon-procedures engagement to verify that all expenditure had supporting documentation and that competitive pricing was obtained for all expenditure over \$5,000.