June 2013 Newsletter

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Audit Time

CCA has been rather busy lately, as the majority of our audit clients have a 31 March Financial Year. This is the main reason why this newsletter is even later than usual. Our client numbers are steadily rising and are knocking on 70 now, with about one or two entirely new clients each week. Fortunately, the number of somewhat larger community groups we work with has also increased, and their fees help a lot in subsidising the smaller ones. Nevertheless, we will need to increase our capacity, and we are waiting for some funder verdicts at the moment.

All our clients have their accounts audited regularly, either by us or another accounting firm. Audits are not particularly well understood, however.

For example, auditors are not actively looking for evidence of fraud. Fraud is only important to auditors if it *materially* (i.e. significantly) affects the Financial Statements. Further down in this newsletter there is an article about the fraud potential in payroll, and it is important to keep in mind that auditors are unlikely to pick them up as long as the total payroll figure is in the right ballpark. If auditors *do* come across evidence of fraud, professional ethics say that they *must* tell you about it, however.

You may not realise it (because we're so cheap), but our audits are a bit tougher than most. Because of the importance of expenditure categories for non-profits' accountability we check your coding a little more carefully, whereas a business auditor is only concerned about the *total amount* of expenditure incurred. We also look for specific disclosures in your Notes that a small business entity would not have (such as information about how you are treating small asset expenditure or how you account for grants). On the other hand we are less concerned on how Statements are presented, as long as the information in it makes sense to those likely to read it. The larger an organisation is, however, the more it is expected (although not legally required) to comply with Accounting Standards.

People often think that auditors primarily check that all the receipts are there. While that is a big part of it, it is also the easy part. My own anxiety generally rises when I see that an organisation has a lot of cash income, including cheques. It is almost impossible to verify that all that income has been banked or otherwise accounted for, and I generally start asking questions about your procedures around handling of the cash to get an idea of what the risk is that I might be missing something large. While community organisations like to trust their volunteers and staff, this is one thing that an auditor must not do. Many auditors 'qualify' their report to make readers aware that they couldn't verify cash income. I try to avoid this if I can by asking those question.

Another important matter to raise here is auditor independence. Auditors for large commercial entities are no longer allowed to also have a hand in producing their financial statements, and many accountants apply this policy indiscriminately now (Chartered Accountants, in fact, must do so now as a condition of membership in the New Zealand Institute of Chartered Accountants). The reason behind this is that an auditor may be reluctant to issue a negative audit report if a lot of income is derived from this particular client from all services, and therefore auditor independence is compromised. You don't bite the hand that feeds you. However, as long as *any* profit is made from audits, there is a financial interest with or without additional business.

For us, these reasons simply do not apply. The majority of our income is derived from funders. Our work on the financial statements of small organisations more often than not does not incur any additional fee. The situation is reversed: we would actually derive a financial benefit from them going somewhere else. If we do a lot of work on Financial Statements or other matters, and then audit those Statements, we make sure that more than one person is involved to remove any bias that comes from 'auditing' your own work. At the moment there is no single client from which we get enough income that the loss of it would hurt us and make us think twice about being objective in an audit. However, this is essentially the decision of the organisation engaging us, and it should be made consciously.

Harald

Cash Accounting Threshold Rising

The Government has agreed to significantly raise the proposed threshold above which not-for-profit organisations have to use accrual accounting. Initially proposed at $40,000 it has now been set at $125,000, which means that 75% of not-for-profits can use cash as the basis for their accounting.

The equivalent threshold for businesses remains at $ 2,000,000.

Accrual accounting is the main factor driving accounting costs in not-for-profits, as auditors and accountants require end-of-year adjustments for accrual purposes. Cash accounting, on the other hand, can generally be handled by non-accountants, and financial reports prepared on a cash basis are better understood in the general population. The difference between financial statements prepared on an accrual or cash basis is usually insignificant for small groups.

Risky Payroll

When it comes to payroll, most organisations probably only worry about getting their IRD returns right, and submitted on time. It is much less known how vulnerable payroll is to fraud – and small organisations with few controls are an easy victim. There is only one other area of operations that is even more vulnerable to fraud (cash income).

The person in charge of payroll has a number of options to unofficially increase their pay a little, especially if they are doing their own. Here's three examples how it can be done:

- Deliberately miscalculating your own deductions. This can easily be done by putting a more favourable tax code into IRD's PAYE calculator or, slightly more risky, putting in a too low gross income. The result of the calculation is then shown to the Board, and the net pay approved on the basis of it. Come PAYE return time, the employee then puts in the real figures. Treasurers or other Board members almost never check PAYE returns against what was actually paid. A fulltime employee can quite easily squeeze an extra $2,000-$3,000 per year out of their employers that way.
- Understating your gross income in the PAYE return, but making deductions for the correct gross income. This has the effect that IRD will think the employee paid too much tax, and they will therefore be entitled to a refund. While this defrauds IRD rather than the employer, the employer fails a legal obligation to file correct returns.
- Making the employer pay your WINZ or Court fines. Sometimes staff have extra deductions to pay for WINZ debts or Court fines. Easy enough to get the AP to WINZ or the Courts authorised – without actually making the deductions from your pay.

There are many, many more ways employers can be defrauded if all aspects of managing payroll are in the hands of one person – a little extra for Kiwisaver or to pay off the Student Loan, for example; how many Treasurers or Board members would notice? And if they do, there's an 'oopsie' effect: it could have been a genuine mistake.

It is not hard to put in some basic checks for payroll without stepping on anybody's toes. Here's what we would suggest for small groups:

1. PAYE and net pay calculations should not be done by the person that organises payment of wages. They should be done by an independent person (Board member, manager), using the information from a Tax Code declaration (IR330).
2. This also applies to any subsequent changes. Manager/Board should only authorise a change in the net pay amount if they have seen the original documents (deduction letters, new Tax Code Declaration etc).
3. Come IRD return time, the manager/Board member should perform a basic check for each employee: Work out the net pay for each employee from the PAYE return you have been given (Gross Earnings minus all deductions). Then add up the pays that employee has received. If the two figures match you're not being defrauded.

Remember that CCA also offers a payroll service for small groups, which means payroll duties are divided up and the risk of fraud or error is much reduced. If you use CCA, a manager/Board member will still have to check that the amounts we have advised to pay are the ones actually being paid, however. More info here.

Farewell Cristian

Some of you will have come across our volunteer Cristian Ionita (the one with the rugged Romanian accent). Cristian has now found a fulltime job with a firm where he is tasked with implementing a new inventory system, and we wish him all the best.