Audit Qualifications – Completeness of Revenue

Many not-for-profit organisations obtain independent audits of their annual financial statements. These may be required by their governing rules, terms of their funding, legislation, or just due to a concern for good governance. However, compared to for-profit entities, audit reports of not-for-profit entities are much more commonly qualified, and in one specific regard: completeness of income. This article looks at why this is and the implications to readers of these qualified audit reports.

Completeness of income qualifications

The most common audit qualification found in NFP organisations relates to the auditor's inability to form an opinion on the completeness of income prior to its recording in the organisation's accounting records. This is due to some key factors that are much more common in the NFP world than in for-profit organisations.

The two main issues involved are:

1. Fundraising revenue such as cash donations, appeals, raffles and the results of other fundraising activities. This is a common feature in NFP organisations. The success or level of revenue expected from such activities is often very hard to predict. This differs to for-profit organisations that generate their revenue from sales of product or services, usually supported by invoices or similar documentation, and hence generate more predictable revenue streams enabling easier completeness assertion verification.
2. NFP organisations commonly have limited resources and use volunteer resources. This translates to limited internal controls such as segregation of duties, qualified accounting staff, appropriate accounting software systems etc. all of which translates to less reliability.

The auditor is charged with forming an opinion based on audit evidence obtained on whether the financial statements as a whole are free from material misstatement. The challenge presented to the auditor regarding fundraising revenue is whether it is possible to obtain sufficient appropriate audit evidence for them to be able to conclude.

Materiality, which essentially means when an amount is considered big enough to be important, is usually assessed against known amounts. However the conundrum for auditors in this situation is how to assess the materiality of something that is potentially missing from the financial statements and of which you cannot easily determine the amount.

Hence this audit qualification is reasonably common.

The wording that you will read in such qualifications (or "modifications" of audit reports as they are generically now known) will be something along the lines of the following:

Basis for Qualified Opinion

The financial statements include [specify type] revenue of [$xxx,xxx] over which limited controls exist prior to the cash received being recorded in the [Trust/Society]'s accounting records. There were no practical procedures available to us to confirm the completeness of this revenue, and accordingly, we were unable to obtain sufficient appropriate audit evidence in this regard. Consequently, we were unable to determine whether any adjustments to the amount of [specify type] revenue recorded was necessary.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements on pages X to Y present fairly, in all material respects, the financial position of trust/society name as at Balance Date, and its financial performance and its cash flows for the year/period then ended in accordance with generally accepted accounting practice

Is this type of audit qualification a problem?

No, generally not. It indicates an inherent risk of the environment the NFP organisation operates in. Hopefully the auditor, if they are a good one, will be assisting their NFP client with advice on how to further implement and strengthen their internal controls. However even then sometimes the audit qualification may still be unavoidable.

Where it is a problem is when an auditor provides a “blanket” qualification over all revenue of a NFP organisation. In our experience this has been all too common in New Zealand in the past when many aspects of the NFP entity’s revenue are easily auditable. For example, many NFP entities gain their revenue from a variety of sources. Some will be fundraising streams such as general donations that are hard to quantify but others will be things like government grants for service which are easily verifiable. An auditor providing a blanket income qualification in such a case is simply not doing a good job nor providing good value to their client and to readers of that NFP entity’s financial statements.

Why will some entities be qualified and others not?

At the end of the day this is a professional judgement issue required of the auditor. It involves assessments of materiality, the circumstances of the entity, and also involves how much audit risk the auditor is willing to take. The key consideration is the level of comfort the auditor can obtain as to the completeness of fundraising revenue and their opinion on this in the context of everything else they know about that organisation. There is no single measure. Rather this comfort comes from a combination of factors including the level and effectiveness of internal controls, history of operations and audits, access to other external information in the environment the entity is operating in etc.

Are there any changes or developments in this area?

In Australia, more so than New Zealand so far, there seems to be an emergence in the use of an Emphasis of Matter Paragraph in the auditor’s report in such situations. This is used where the auditor has formed a judgement that they can issue an unqualified audit opinion but that they still believe it is fundamental to the users understanding of the financial statements to draw their attention to the inherent risk of the NFP’s operating environment as it relates to revenue recognition from fundraising sources. The emphasis of matter paragraph should be referring to the client’s disclosure of the issue i.e. their revenue recognition policy and disclosure of the limitations that exist in relation to recording of cash receipts.

Possibly this would also be helpful to better educate NFP financial statements readers in New Zealand of this issue.

About the Author

Craig Fisher FCA is an Audit Partner and Chairman of RSM. Craig is a specialist regarding not-for-profit and charitable entity issues.

Contact Craig on:
D: +64 (9) 367 1654
E: craig.fisher@rsmnz.co.nz
W: www.rsmnz.co.nz