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## **AUDITOR GENERAL OF CANADA FALL 2010 REPORT**

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*By Terrance S. Carter and Karen J. Cooper\**

### **A. INTRODUCTION**

The Auditor General of Canada recently completed and published her Fall 2010 Report (“Report”) to Parliament on October 26, 2010.<sup>1</sup> The report can be accessed on the Office of the Auditor General of Canada’s website at [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201010\\_07\\_e\\_34290.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201010_07_e_34290.html). One chapter of the Report was dedicated entirely to the performance of the Charities Directorate of the Canada Revenue Agency (“CRA”) with regard to its oversight of registered charities. The Report examined several different issues relating to compliance with the *Income Tax Act* (“ITA”), tax shelter gifting arrangements, and communications of CRA to the public. An audit of this kind from time to time is imperative, since Canadians donate approximately 8 billion dollars to the 85,000 registered charities in Canada each year. Because of the role that CRA plays in regulating these charities, an audit by the Auditor General is an important means of ensuring that CRA is carrying out practices and methods which protect these donors and the tax base.

Overall, the Auditor General found that CRA’s procedures are effective and thorough. A majority of the areas examined received positive feedback from the Auditor General. However, there were also a number of

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<sup>1</sup> “2010 Fall Report of the Auditor General of Canada.” Office of the Auditor General of Canada. October 26, 2010. [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201010\\_e\\_34282.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201010_e_34282.html)

recommendations proposed to bring improvements, with which CRA has indicated it is in full agreement. The findings of the Auditor General are discussed in more detail below.

## **B. FOCUS OF THE AUDIT**

The main objective of the Report of the Auditor General was to determine whether the Charities Directorate of CRA had processes designed to increase compliance with the charities' provisions of the ITA. The three lines of inquiry that the Report centred around included:

- a) Whether the processes that CRA uses are increasing the level of compliance of Canadian registered charities with the ITA;
- b) Whether CRA has appropriate processes designed to increase compliance with the ITA related to tax shelter gifting arrangements; and
- c) Whether the communications of CRA are designed to increase donors' and charities' level of awareness of the relevant provisions of the ITA.

The Report touched on each of these issues throughout the document. The audit analyzed a compilation of records, including documents and reports from CRA, databases relating to applications for registration, audits planned and completed by CRA relating to charities and tax shelters, and revocations.

## **C. OBSERVATIONS AND RECOMMENDATIONS**

### **1. Process for Registering Charities**

As CRA is responsible for the administration of the provisions of the ITA relating to registered charities, their main function is to review applications for charitable registration and to ensure that existing registered charities are meeting the requirements of the ITA. Since CRA has the highest level of involvement with a charity during the registration period, this is a very important process. During the audit, random samples of applications were reviewed and the methods of CRA employees were examined thoroughly. The Auditor General found that CRA's methods were adequate and functioning very well. The Audit also determined that CRA was taking steps to meet registration service targets.

## 2. Late Filing of Annual Information Returns

According to provisions of the ITA, the filing of the T3010 package must occur annually and on time for an organization to maintain its registered charity status. As a result of the current follow-up process for outstanding returns which involves issuing reminders to charities and then revoking registration during the tenth month after the charity's year end, many charities submit their returns late. Also, the Report noted that the public may not be aware that a charity has failed to file its return, since only those organizations that have had their status revoked for failure to file are listed on CRA's website. The Auditor General recommended that CRA re-evaluate their current process for dealing with annual information returns, to ensure compliance and that returns are received on a timely basis.

## 3. Audits

CRA has an audit and review process that selects registered charities for annual audits when a potential high-risk issue is identified. The Auditor General found that compliance was generally not an issue with a majority of CRA's audits. However, there was a recommendation proposed to develop and execute a random audit sampling plan, which will ensure reliable findings that will permit CRA to measure an overall compliance rate for registered charities.

## 4. Internal Guidance for Applying Sanctions

CRA has several sanctions available to encourage compliance with the ITA, with some being more severe than others. A few examples of possible measures that may be taken by CRA to encourage compliance include: offering educational seminars, signing a compliance agreement, imposing financial penalties, or revocation. According to the Auditor General, the guidelines that CRA is currently using for applying the appropriate sanctions to registered charities are not sufficiently detailed.<sup>2</sup> The Auditor General advised that CRA should carry out an evaluation of the effectiveness of its use of various tools and sanctions in order to increase compliance with the ITA.

## 5. Monitoring the Assets of a Revoked Charity

CRA is responsible for ensuring that the assets of a revoked charity are properly disposed of in accordance with the ITA. A charity that has had its registration revoked must either transfer its net

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<sup>2</sup> "Guidelines for Applying the New Sanctions." Canada Revenue Agency. September 9, 2009. <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/nwsnctns-eng.html>

assets to an eligible donee, use the assets for charitable activities or programs, or remit the assets to the Crown within one year of its revocation. According to the Report, CRA does not currently have any formal process to ensure that it monitors whether a charity has transferred the assets as required on revocation of its charitable status. The Auditor General suggests the implementation of a more formal monitoring procedure for the assets of revoked charities.

## 6. Communication with Charities and Donors

CRA provides the general public with publications and general information on registered charities and donors. Overall, the Auditor General found that CRA provides a wide variety of media available for the public and that the resources are user-friendly. Also, the approach to communications taken by CRA in terms of evaluations of individual information sessions and the accuracy of the information being provided was determined by the Auditor General to be adequate.

## 7. Tax Shelter Gifting Arrangements

Tax shelter gifting arrangements are used by many taxpayers as part of making donations to charities and can be an effective means of reducing taxes. However, many of these tax shelters become involved in issuing donation receipts in excess of the cash invested or property donated, which creates problems for CRA and ultimately donors. As a result of a draft amendment to the ITA issued by the Department of Finance Canada in 2003, these ‘buy-low, donate-high’ tax shelters are no longer permitted under the ITA and CRA has undertaken a number of actions to curtail the use of such structures.<sup>3</sup>

According to the Report, the general public has an expectation that CRA will provide it with timely and relevant information regarding any questionable tax schemes and shelters. CRA understands the importance of providing this information to the public, and according to the Auditor General’s investigation, they have made reasonable efforts to keep the public informed and warn them of potential abusive tax shelter arrangements.

For those organizations and individuals that continue to be involved with tax shelter gifting arrangements, the Auditor General’s report confirms that CRA will perform audits on all of the parties

involved: the promoters, the registered charities, and the participants. The Auditor General's report emphasized the importance of CRA continuing to invest time and resources to prevent taxpayers' participation in these kinds of arrangements.

## D. CONCLUSIONS

Overall, the feedback from the audit was encouraging for the charitable sector. CRA's practices in performing its role as the regulator of registered charities in Canada appear to be operating successfully, with several minor modifications required. The Auditor General's Report represents an important commentary on the performance of CRA with regard to its oversight of registered charities and, therefore, should be carefully studied by those interested in the sector.