



Registered Charities and CRA Charity Audits

By Gary Huenemoeder, Mark Blumberg and Maddy Sawyer (March 2, 2019)

The Canada Revenue Agency's (CRA) Charities Directorate is the de facto regulator of Registered Charities in Canada. They are responsible for the registration of charities in Canada. Registered charities have the ability to issue official donation receipts. In turn, those receipts allow Canadian taxpayers to claim a tax credit for their contributions to registered charities which can be very valuable.

In 2016, registered charities issued over \$16 billion in tax receipts and received \$261 billion in revenue.¹ With such large amounts being mostly tax-exempt or carrying tax benefits, it is important for CRA to ensure that registered charities are properly regulated and following the rules and regulations for Canadian registered charities.

One of the ways that CRA regulates charities is by conducting audits. There are 5 Tax Services Offices across the country that perform the audit function, along with the Charities Directorate in Ottawa who occasionally conduct audits. The five offices are Halifax, Montreal, Kitchener-Waterloo, Edmonton and Victoria.

It is important to note that the mandate of the Charities Compliance Branch is to educate and assist charities in complying with the Income Tax Act, meaning their goal is not to de-register charities. Rather, their goal is to help charities operate responsibly and to help foster Canadians' confidence in the charity sector.

Charity files are screened for possible audits in Ottawa using various risk factors as outlined on CRA's charities webpage:

- referral from another area of CRA;

¹ Blumbergs Canada Charity Sector Snapshot 2016,

https://www.globalphilanthropy.ca/blog/blumbergs_canadian_charity_sector_snapshot_2016

- complaints from the public;
- articles in the media or other publicly available sources;
- review of specific legal obligations under the Income Tax Act;
- information from their T3010 annual information return; and
- follow-up on a previous compliance agreement.

CRA also randomly selects charities for an audit, although this is less and less common.

The Charities Directorate of CRA is increasingly using various analytical tools for the selection of audits. The tools can track items such as the disbursement of funds to a qualified donee and compare that to what was reported on the charity's T3010. As a result of the use of the analytics, CRA is also looking at more of a risk-based approach to auditing which falls in line with the Compliance division of CRA who performs the regular tax and HST/GST audits.

Currently CRA's goal is to audit the highest risk charities. High risk charities include charities that are captured by CRA's "postal code project", in which [CRA announced](#) it would be closely examining the tax returns of Canada's richest homeowners, as well as review all of the corporate holdings that the owner of the home is or has been involved in. The corporate holdings under review include any associated charities.

Other high-risk charities include those who receive large funds from outside of Canada or send large amounts outside of Canada. As of 2015, financial institutions report any transactions over \$10,000 related to funds received or funds transferred out of Canada by any organization, including charities, to CRA. CRA can use this information to verify information submitted on a charity's T3010.

If your charity is selected for an audit, it is advisable that your legal counsel and accountant be advised as soon as possible. They can assist in the preparation for the audit and assist in identifying any issues up front. Although Blumberg Segal LLP assists many charities with audits we actually prefer that charities use our informal review programs long before any audit takes place so that we can assist in managing risk in a less stressful environment and at much lower cost. [Here](#) is an article on such informal legal reviews.

By the way having a law firm that is very knowledgeable about charity audits conduct the informal review is typically better than having accountants do the same review as the findings of the lawyer have solicitor-client privilege whereas the findings of the accountant may have to be provided to CRA!

The CRA Charity Audit Process

An auditor will be assigned the file and prepare an audit plan which will identify the areas of potential non-compliance determined by Ottawa plus other areas of concern they note in their review of file. They will then call the charity to arrange a mutually convenient time to conduct the audit. The auditor will not go away if you do not respond to any messages

left or letters sent, so the best approach to an audit is to answer as accurately, completely and quickly as possible. They will also send an engagement letter which will outline the years to be audited, the books and records that should be made available. Your responsibility as a charity is to comply with the documents and information requested, unless a document does not have to be provided because of solicitor client privilege.

On the day of the audit the auditor will arrive and will want to interview a director and/or the ED/CEO of the charity. The interview can go for 2-4 hours. It is a good idea to take your own notes of the interview. With any questions that you cannot answer it is best that you not guess! You can obtain the answer and provide it later to the auditor. Provide the auditor with a proper work space and do not put the auditor in a garage, shed or any other area that is not acceptable. You have the right to ask the auditor why the charity was selected for audit. There may be an explanation or documents that you can readily provide to shed light on the main concern(s) identified.

The auditor's review may include some of the following, among other things:

- The charity's books and records, tracing them to the financial statements and the T3010 filed;
- The various allocations of expenses and revenues and determine if any benefits were provided to employees and directors;
- The receipting of donations, cash, advantage and gifts in kind;
- Any internal controls in place for the receipting and expenses;
- The activities of the charity: are they doing what they are registered for? Are all the activities charitable in nature?; and
- Various documents including emails and social media to determine if all your activities are charitable.

Audit Outcomes

The auditor will normally discuss their finding with the charity during the audit and before issuing a final letter. Any misunderstandings can be cleared up throughout the audit. It is important to keep all lines of communication open. The auditor will issue a final letter once the file has been approved by the auditor's team leader and possibly the Charities Directorate. The final letter will be one the following:

Clean Letter: No issues were noted that would have an impact on the charitable registration.

Education letters: When the non-compliance is minor, the CRA will send an education letter. The letter will identify where the charity has not followed the law and will offer

guidance to the charity so that it can make the required changes. An education letter does not adversely affect the charity's registration, and the charity does not have to reply to the letter.

Compliance agreements: In cases of moderate non-compliance, the Charities Directorate may suggest entering into a compliance agreement with the charity. A compliance agreement outlines the non-compliance issues and the remedial actions that the charity has agreed to take, sets out the timelines for the necessary changes, and outlines the consequences if the charity does not follow the agreement. CRA will follow up to make sure the charity is acting according to the agreement. It is very important with compliance agreements that the charity fully complies with the terms of the compliance agreement.

Sanctions: In cases of serious or repeat non-compliance, CRA may propose imposing a sanction (financial penalties or the temporary suspension of the charity's tax receipting privileges or both). CRA may also propose imposing a sanction when the charity has been found to be disregarding the terms of its compliance agreement.

Revocation of registration: When CRA finds a serious case of non-compliance, it will propose revoking the charity's registered status. Although CRA usually uses revocation as a last resort, under the Act CRA can revoke a charity's registration at any time, when it is appropriate. This includes situations where:

- the non-compliance is serious and intentional;
- the non-compliance has had a substantial, adverse effect on others (beneficiaries, donors, or funders); or
- the charity had a previous record of serious non-compliance or cannot or will not follow the rules.

A charity whose registration is revoked must dispose of its assets within one year to other charities or pay a 100% revocation tax on any assets remaining. This tax helps make sure the funds donated for charitable purposes stay in the charitable sector.

Annulment of registration: In rare cases, an auditor may find that a charity was not established and operated for exclusively charitable purposes when it was registered, or a change of law has caused it to no longer qualify as a charity. Although CRA is obligated to remove the charity's registration because it should never have been registered, it may be unfair to penalize it by applying the revocation tax to any assets it has accumulated. In such cases, the Act allows CRA to propose to annul the charity's registration. A charity whose registration is annulled can no longer issue tax receipts, but it can keep its assets.

For the March 31, 2018 fiscal year, the following statistics were released by CRA showing the results of the previous years audits:

- 313 Education letters
- 92 Compliance agreements

- 51 No action required
- 35 Voluntary revocations
- 25 Notices of intention to revoke
- 27 Other
- 5 Sanctions
- 0 Annulments

A total of 548 audits were completed in this year. This represents approximately .6% of all of the registered charities in Canada. Although, the chances of being audited by CRA appears low you should never take for granted that you will not be subject to an audit!

Ultimately, the best way to deal with a CRA audit is to regularly review your charity's internal practices to ensure you are complying with Canadian charity law long before you even receive an audit letter. Blumberg Segal LLP offers free resources, a number of different programs during the year, customized in house training, and can be retained to provide help and advice, as well as informal internal reviews, that can assist your charity to stay compliant.

Additional Resources

[New Canadian Registered Charity Legal Checklist by Mark Blumberg](#)

[Blumbergs' Receipting Kit for Canadian Registered Charities](#)

[Blumbergs' Canadian Charity Sector Snapshot 2016](#)

[Informal Risk Reviews are Excellent value for Money for Registered Charities](#)

[Upcoming Webinars for the Canadian Charity Law Association](#)

[Top Tips for Serving as a Director of a Canadian Registered Charity by Mark Blumberg](#)

[CRA increasingly focused on and auditing internal controls of registered charities](#)

[Ignorance isn't bliss for large registered charities anymore as CRA focuses audits on them](#)

[CRA's Fundraising Guidance is the most important compliance document for Canadian fundraisers](#)

[CharityVillage Top Charity Compliance Issues for Canadian Registered Charity with Mark Blumberg](#)

[Blumbergs' Foreign Activities Directory](#)

[Canadian Charities and Foreign Activities – A Very Simplified View of the Process](#)

[With foreign activities what is the difference between a conduit and a structured arrangement?](#)

[Canadian Charity Foreign Activity Legal Checklist – Working with Foreign Charities or Intermediaries](#)

[Issuing complete and accurate donation receipts](#) – CRA checklist

[Income Tax Folio S7-F1-C1, Split-receipting and Deemed Fair Market Value](#)

[Books and records](#) – CRA guidance

[Guidance CG-002, Canadian registered charities carrying out activities outside Canada](#)

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