

29 September 2022

**External Reporting Board
PO Box 11250
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Tier 3 and 4 proposed changes submission

Thank you for the chance to comment on the proposed changes to the Tier 3 and 4 NFP standards. Our company provides software for a significant number of NZ assurance firms. As such we talk to many practitioners and we see quite a few audit and review files as part of our training and quality control support work. While the comments below are my own, many do relate to discussions with practitioners.

Service performance

The proposed changes in Tier 3 are simply following the direction set by PBE FRS 48 and NZ AS-1. The terms *Outcome* and *Output* were always confusing, so these being replaced with more descriptive terminology as per PBE FRS 48 are a welcome change. *Entity Information* no longer being a prescribed report, so long as the information is included elsewhere is also welcome.

The guidance provided about what to report as SPI, and how to report it is generally clear and should be very helpful.

In my opinion, it makes sense to align SPI reporting with the other standards, as it should be more efficient for preparers and auditors, and more understandable to users.

From an audit perspective, NZ AS-1 is a complex standard that feels like overkill for auditors of smaller entities. Perhaps when the NZ version of the LCE auditing standard is released there may be something size-appropriate for auditing SPI for Tier 3 and 4 entities.

Changes to standard revenue and expenditure categories

A common criticism of reporting under the existing Tier 3 standard is that the reporting categories are so broad as to be almost meaningless in some cases because so much is amalgamated under such generic headings. The proposed changes are welcome, and seem to be well thought through.

Preparers of performance reports will be able to adjust the names of the categories, to use appropriate terminology but will not be allowed to add additional categories as before. I assume that this is for is probably for aggregation and analysis purposes. I have some concern this may lead to some drastic redefinition of categories, but that will be up to the auditors to check.

I think these changes generally make sense. They should make the statement of financial performance more meaningful and reduce the need for extensive notes breaking down the categories.

Revenue recognition changes

Under the new proposals, if there is a clear expectation of when funds are to be used in terms of an agreed expectation from the grantor, the revenue may be recognised as or when the conditions are satisfied.

This seems like a clear, common-sense response, more in line with the commonly accepted matching principle of accrual accounting.

Alternative measurement for assets

The new proposal to allow revaluation based on say, RV (rateable value) for land and buildings, or valuation by an independent qualified valuer, with changes made straight to a revaluation reserve seems like a sensible improvement.

The rules are to be applied to assets that do not require significant judgement or complex estimates. Investment property may also be included as their own category under fixed assets and revalued in the same way. It is proposed that financial assets (shares etc.) be measured at their current value, with changes in value put through the statement of financial performance.

Again this all seems sensible and familiar and simple enough for preparers and auditors.

Including a note on accumulated funds

The proposal is that for transparency there be a note that discloses objectives and policies for managing accumulated funds, and any plans for applying accumulated funds to meet the entity objectives. This to be a high-level informational view and not a binding commitment.

I can see advantages to this disclosure. It will make entities think about why they have significant reserves (if in fact, they do) and perhaps how they could be better using these to meet their objectives. If they view their reserves as investments, are they making the best use of their capital? Could they be meeting their objectives in more efficient ways with a redeployment of their equity?

On the other hand, many charities certainly don't have excess cash or investments and their equity simply represents assets such as land and buildings that are essential to their service delivery. Having to make up a nice story to put into a note in these cases seems like a pointless exercise. This could also be difficult to audit. Perhaps there could be some fine tuning here where accumulated funds represented by cash and investments only need a note.

Simplification to the statement of cash flows

Cash flow statements are typically a headache for both preparers of financial statements and auditors. Accounting software often struggles and the results are hard to audit and hard for users to understand.

The proposal is that the categories in the statement of cash flows match the categories in the statement of financial performance. It seems to be that the statement of cash flows is to be essentially a statement of receipts and payments.

I think this is a brilliant idea. It will be easier to prepare (just based on the cash report in Xero say), easier to audit, and probably more useful to users.

Change of name

The change in name of the new standard to *Reporting Requirements for Tier 3 Not-For-Profit Entities* is a welcome improvement from the old tongue twister.

Transitional arrangements

I note that appendix B for transitional arrangements has not been updated. Here will obviously need to be some thought put into how to move from the old standard to the new one, especially in terms of revenue recognition changes, and category changes. For assets previously valued using Tier 2 standards, what will be allowed in terms of backing out back to the new method?

Tier 4 proposed changes

The changes proposed for Tier 4 reflect the changes in categories proposed for Tier 3, some simplified requirements for really small entities (under \$10k expenditure), changing the language around outcomes and outputs, removing the need for a statement of resources and commitment and replacing this with a note, and changing the name of Statement of Receipts and Payments to Statement of Cash Received and Cash Paid.

In general, these changes seem fairly trivial. The only comment I have is that the name change to *Statement of Cash Received and Cash Paid* could actually be confusing. Most non-accountants think of cash as the paper money we get out of ATMs, as opposed to direct payments and EFTPOS. A backwards and unnecessary step in my opinion. Perhaps *Statement of Money Received and Money Paid* would be clearer?

Overall response

It seems as if the drafters of the proposed changes to the Tier 3 and 4 standards have taken time to test the wind well and come up with a sensible result. Of course, there will always be details to iron out in the execution. Overall I think this is a very positive move that will produce more meaningful performance reporting.

Best regards,



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