



NZ ACCOUNTING
STANDARDS
BOARD

EXPLANATORY GUIDE A8 FINANCIAL REPORTING BY NOT-FOR-PROFIT ENTITIES: THE REPORTING ENTITY (EG A8)

Issued November 2017

This Explanatory Guide provides guidance for not-for-profit entities in determining the boundaries of the reporting entity when preparing general purpose financial reports in accordance with standards issued by the External Reporting Board or its sub-Board, the New Zealand Accounting Standards Board.

This Explanatory Guide is an explanatory document and has no legal status.

It supersedes Explanatory Guide A8 *Financial Reporting by Not-for-profit Entities: The Reporting Entity* issued in October 2014.

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Introduction

1. The objective of this Explanatory Guide (EG) is to help not-for-profit (NFP) entities that prepare a general purpose financial report (GPFR), in accordance with standards issued by the External Reporting Board (XRB) or its sub-Board, the New Zealand Accounting Standards Board (NZASB), to work out the boundary of the reporting entity. Identifying the boundary of the reporting entity requires consideration of (i) whether branches are part of the reporting entity, (ii) whether branches are separate reporting entities, and (iii) whether the reporting entity has a relationship for financial reporting purposes with any other entities (see Explanatory Guide A9 *Financial Reporting by Not-for-profit Entities: Identifying Relationships for Financial Reporting Purposes* (EG A9)). Reporting entities are then able to determine which activities, transactions and balances to include in their financial report or performance report, hereafter referred to as “financial reports”. Because many NFP entities are registered charities this EG refers to some issues that are specific to registered charities.
2. The financial report of a reporting entity should reflect all the transactions, balances and activities of that entity to enable users of the financial report to make appropriate decisions about resource allocation and to hold management of the entity to account.
3. XRB A1 *Application of the Accounting Standards Framework* sets out the criteria to be eligible to report in accordance with the various tiers of financial reporting and the relevant standards for each tier. The identification of the reporting entity, including the existence of relationships for the purpose of financial reporting, can affect which tier an entity is eligible to report in accordance with. For example, for the purpose of applying the legislative size threshold for Tier 4 PBE Accounting Requirements, total operating payments means the combined operating payments of the entity and all its controlled entities.
4. There can be a tension between complying with the relevant accounting standards and the way in which charities register with the Department of Internal Affairs, Charities Services. For example, several entities registered as a ‘group’ under the Charities Act 2005 may not be a ‘group’ for financial reporting purposes. Similarly, entities may register separately under the Charities Act 2005 but for financial reporting purposes some, or all, of those entities may be components of an NFP entity or a group. A reporting entity that controls one or more other entities for financial reporting purposes and reports in accordance with Tier 1, Tier 2 or Tier 3 PBE Accounting Requirements, is required to consolidate those entities in its financial report. EG A9 discusses the concept of control for financial reporting purposes.
5. In light of this tension, charities may want to think about their reporting obligations and how best to register with Charities Services in order to minimise the compliance costs of preparing financial reports.
6. This Explanatory Guide is not a substitute for reading XRB A1 and the relevant accounting standards – its purpose is to help NFP entities in deciding what transactions, balances and activities need to be included in the financial report of a reporting entity.

Objective of Financial Reporting

7. The *Public Benefit Entities’ Conceptual Framework* (PBE Conceptual Framework) notes that the objectives of financial reporting by public benefit entities are to provide information about the entity for accountability and for decision-making purposes.
8. Financial reporting is not an end in itself. Its purpose is to provide information useful to users of GPFR. The objectives of financial reporting are therefore determined by reference to the users (for example, taxpayers, donors, lenders, suppliers, members and employees) of GPFR, and their information needs.
9. Although financial reports do not provide all the information that users may need to make decisions, it is important that they include all the transactions, balances and activities of the reporting entity to enable users to make appropriate decisions. Incorrect or inappropriate decisions are likely to be made if relevant information is omitted from GPFR.
10. Financial reports show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Users of a reporting entity’s financial report may also be interested in how well the entity has demonstrated its accountability in relation to a range of obligations including the entity’s compliance with legislation, regulations, common law and contractual arrangements.

The Reporting Entity

11. A reporting entity is an entity whose financial statements, group financial statements, reports, or other information is required by any enactment to comply, or be prepared in accordance, with GAAP or a non-GAAP standard.¹
12. For example, an entity that is registered as a charitable entity² under the Charities Act 2005 is a reporting entity because charitable entities are required to prepare financial statements in accordance with GAAP³ (or a non-GAAP standard)⁴ and to file those financial statements with the Department of Internal Affairs, Charities Services. As mentioned above, there may be a tension between an entity's financial reporting requirements and how it has registered under the Charities Act 2005. Such tensions may lead to a reconsideration of the way an entity is registered.
13. There may be a number of factors that influence registration decisions. This Explanatory Guide does not consider those factors. Entities seeking information on registration should consult with the relevant organisations, such as Charities Services and Inland Revenue.

Identifying the Reporting Entity

14. For financial reporting purposes, a reporting entity can be a single entity or several entities that are an economic entity (group).
15. Although this guidance applies to identifying the boundary of single reporting entities and group reporting entities, it can sometimes be helpful to first establish the boundary of the single entity and then determine whether, for financial reporting purposes, the single entity controls other entities or is itself controlled by another entity. Where an entity controls one or more entities (whether registered charities or otherwise) for financial reporting purposes, this is referred to as a 'group'⁵ or an 'economic entity'.⁶
16. The reporting entity is relatively simple to identify if it has legal status, such as if it is registered as a company, a charitable trust or an incorporated society. In such cases, all of the transactions are entered into in the legal name (or trading name if different) of the entity, the assets are owned by the entity and the entity is responsible for the liabilities it incurs.
17. However, where an NFP entity is unincorporated, that is, it has no legal status⁷ (for example, an unincorporated trust), identification of the reporting entity may not be so straightforward. For example, an NFP entity consisting of many branches may consider itself to be one reporting entity. As one reporting entity, it would need to identify and collate all of the transactions undertaken by it (and the many branches), or on its behalf, for inclusion in its financial report. Conversely, branches affiliated to, but not part of, an NFP entity may be constituted and established as separate reporting entities. This means that each branch would include only transactions undertaken by it, or on its behalf, in its own financial report.
18. Appendix A contains illustrative examples for determining the transactions, balances and activities to be included in the financial report of the reporting entity when the reporting entity has legal status and when the reporting entity has no legal status.

What Should be Included in the Financial Report of a Reporting Entity?

19. The financial report of a reporting entity should include all of the transactions, balances and activities of the reporting entity.

¹ Section 5 of the Financial Reporting Act 2013.

² 'Charitable entity' is the term defined in section 4 of the Charities Act 2005. The term 'charitable entity' in this Explanatory Guide has the same meaning as 'registered charity'.

³ Generally accepted accounting practice is defined in section 8 of the Financial Reporting Act 2013:

Financial statements, group financial statements, a report, or other information complies with generally accepted accounting practice only if the report, statements or information comply with:

(a) applicable financial reporting standards; and

(b) in relation to matters for which no provision is made in applicable financial reporting standards, an authoritative notice.

⁴ Section 42A of the Charities Act 2005. XRB A1, paragraph 5, explains that Tier 4 PBE Accounting Requirements are a non-GAAP standard.

⁵ In the For-profit Accounting Requirements.

⁶ In the PBE Accounting Requirements.

⁷ An entity that has no legal status is a reporting entity when it is registered under the Charities Act 2005 or under any other legislation that requires it to prepare financial statements that comply with GAAP or a non-GAAP standard.

Branches and Similar Networks

20. Many NFP organisations operate through branches or similar networks. Where the branch is a component of the reporting entity (for example, an internal subdivision of the reporting entity), the activities of the branch are included in the financial report of the reporting entity. This does not prevent the branch from preparing financial reports about its activities to meet the information needs of its stakeholders in a form that is appropriate for those stakeholders.
21. Where a branch of an NFP organisation is established as a separate legal entity, the NFP organisation needs to consider its relationship, if any, with that branch for assessing the relevant tier for financial reporting purposes. See EG A9 for further guidance on the nature of relationships for financial reporting purposes and the relevant accounting requirements. Similar to a branch that is an internal subdivision of a reporting entity, the branch that is a separate legal entity may decide to prepare financial reports about its activities to meet the information needs of its stakeholders even if it does not have statutory reporting obligations.
22. In some cases, NFP organisations may pay a subscription or fee to a national organisation as a means of funding that national organisation. The national organisation then has responsibility for establishing the broad parameters under which the NFP organisations operate. Depending on the circumstances, the NFP organisations may be:
- (a) Part of the national organisation, in which case the transactions and activities of the NFP organisations are included in the financial report of the national organisation;
 - (b) Separate legal entities with a relationship with the national organisation for financial reporting purposes, in which case that relationship needs to be determined so that it can be properly accounted for; or
 - (c) Separate legal entities with no relationship with the national organisation for financial reporting purposes, in which case the NFP organisations will prepare their own financial report in accordance with the relevant accounting standards.
23. As noted in paragraph 22(a) above, in some cases NFP organisations might be part of a national organisation. However, NFP organisations are unlikely to be part of a national organisation if:
- (a) NFP organisations can choose whether or not to be a member of the national organisation;
 - (b) The national organisation does not have access to the resources of the NFP organisations or control over the activities of those NFP organisations; and
 - (c) The NFP organisations are not responsible for the obligations of the national organisation.
24. In some cases, NFP organisations are established as separate legal entities. In deciding whether or not there is a relationship for financial reporting purposes the NFP organisations would need to consider, among other things, whether they are able to change their constitution without approval, and who has the ability to establish and disestablish the NFP entities (see EG A9 for further guidance on the nature of relationships for financial reporting purposes).
25. There could be cases where NFP organisations have set up an overarching governing body solely for administrative purposes, such as to assist NFP organisations' operations. The governing body may have no decision-making power but it may have the ability to establish and disestablish organisations. In such cases, the individual organisations and the governing body need to consider what the nature of their relationship is for financial reporting purposes (see EG A9 for further guidance on the nature of relationships for financial reporting purposes).

Umbrella Organisations

26. Some entities, described as 'umbrella' organisations, may have member organisations or individual members who work together to co-ordinate activities or pool resources. In some cases, the members may belong to the umbrella organisation in the same way that people join a sporting body or other NFP entity (that is, the members pay a subscription or fee in return for access to services or benefits). Relationships

entered into solely for services generally mean that the member organisations are not part of the umbrella organisation for financial reporting purposes.

Other Scenarios

27. If it is unclear what is to be included in the financial report of a reporting entity (for example, when the entity has no legal status), the following guidance assists in determining which transactions, balances and activities should be included.
- (a) All transactions and activities undertaken using the reporting entity's identity (for example, charity registration, legal name where the entity has legal status) are considered to be activities and transactions of the reporting entity.
 - (b) Transactions undertaken and balances held in the name of the reporting entity (for example, balances held in trust on behalf of the reporting entity) are considered to be transactions and balances of the reporting entity.
 - (c) Funds and associated transactions are considered to be funds and associated transactions of the reporting entity if they are solicited in the name of, and with the approval of, the reporting entity (for example, a fundraising event in the name of the reporting entity) by a third-party fundraiser acting as an agent of the reporting entity.

Registered Charities

28. Accounting standards contain the recognition, measurement, presentation and disclosure requirements for the items to be included in the financial report.
29. Section 41(2)(b) of the Charities Act 2005 requires the annual return of a charitable entity to be accompanied by a copy of the financial statements⁸ and section 42A requires those financial statements to comply with GAAP (for a specified NFP entity⁹) or a non-GAAP standard (for entities other than a specified NFP entity).
30. In the case of registered charities there are specific requirements in the Charities Act 2005. Section 44 of the Charities Act 2005 permits the registration of several entities that are affiliated or closely related as a 'single entity'. Where several entities are registered as a 'single entity', the financial statements that accompany the annual return are prepared either (i) on a consolidated basis in respect of the single entity,¹⁰ or (ii) separately in respect of each entity that forms part of the single entity.¹¹ Charities Services determines the manner in which those financial statements are to be prepared,¹² in consultation with the entities concerned, but the financial statements must still comply with GAAP or a non-GAAP standard unless an exemption has been granted under section 43 of the Charities Act 2005.
31. In order to reduce complexity and compliance costs, a charitable entity may want to register in the manner that reflects its statutory financial reporting requirements. This involves identifying any relationships that the entity has with other entities for financial reporting purposes, including considering (i) whether the entity controls any other entities, and (ii) whether the entity is controlled by another entity. The outcome of this assessment might result in some entities deciding to change the manner in which they are registered with Charities Services. One option is for a charitable entity that is in a controlling relationship for financial reporting purposes to apply to be registered as a single entity group. Charities Services can set reporting terms and conditions that allow the parent to prepare and file the annual return and accompanying consolidated financial statements. This will minimise the compliance costs for the members in the group, as they are not required to prepare their own separate financial statements.
32. Appendix A provides examples of the financial reporting requirements for registered charities in different circumstances.

⁸ Because the Charities Act 2005 refers to financial statements, that term has been used in this section.

⁹ A specified not-for-profit entity is an entity in respect of an accounting period if, in each of the two preceding accounting periods of the entity, the total operating payments of the entity are \$125,000 or more (section 46 of the Financial Reporting Act 2013).

¹⁰ Although several entities might be registered as a 'single entity', they may not necessarily be a group or an economic entity for financial reporting purposes.

¹¹ Section 46(1A) of the Charities Act 2005.

¹² Section 46(1B) of the Charities Act 2005.

Appendix A

Illustrative Examples

Where the Entity has Legal Status

Local Golf Club (Inc) is registered as an incorporated society under the Incorporated Societies Act 1908 and is also registered as a charitable entity under the Charities Act 2005. The entity is able to transact, purchase assets and incur liabilities in its own name. The members of Local Golf Club (Inc) are not responsible for the debts of the entity. A consequence of the entity having legal status is that the activities and transactions undertaken by the entity are easily identifiable because they are undertaken in the entity's legal name.

Local Golf Club (Inc) is therefore a reporting entity for the purposes of preparing its financial statements.¹³

Where the Entity does not have Legal Status

A national charitable organisation is registered as a charitable entity under the Charities Act 2005. The organisation comprises a Head Office and ten branches that operate independently of the Head Office but within the terms of the Constitution of the organisation. Each branch maintains separate accounting records on an accruals basis and bank accounts in its own name. The organisation and its branches are treated as a single entity under the Charities Act 2005 and prepare financial statements on a consolidated basis as the Head Office has determined that it controls the branches for financial reporting purposes.

Branch A establishes a sub-committee to raise funds specifically to send delegates to an international conference in Australia. A new bank account is opened in the name of the treasurer of the sub-committee in trust for the delegates that will attend the conference. Funds raised are deposited into this account and expenses in respect of the fundraising events are paid out of this bank account. The delegates agree that they will contribute any difference between the funds raised and the costs of attending the conference. At the reporting date, this bank account has a nil balance and is in the process of being closed because the fundraising is complete and the delegates have attended the conference.

The transactions in the bank account form part of the transactions of Branch A and are included in the financial statements of Branch A. Although the bank account was opened in the name of the treasurer of the sub-committee in trust for the delegates, attendance at the conference is on behalf of, and for the benefit of, Branch A. These transactions are also transactions of the national charitable organisation and are included in the financial statements of the single reporting entity prepared in accordance with the relevant accounting standards.

If these transactions are not included in the financial statements, those financial statements do not reflect the total activities of Branch A, or of the national organisation, for the reporting period.

Registration under the Charities Act 2005

NFP entities A, B, C and D were established to collect and distribute donations of food, clothing and furniture to families in need. The governing bodies of the entities meet on a regular basis to share experiences and keep each other informed of their activities and needs. The entities work together co-operatively to meet the needs of the families who contact them. When an entity is in urgent need of items that it doesn't have, the entity contacts the other entities to source those items where possible. Two possible registration scenarios are outlined below.

Scenario 1 – Separate Registration

NFP entities A, B, C and D are registered as separate entities with Charities Services. The NFP entities have determined that Entity C controls all of the other entities for financial reporting purposes.

In this situation:

- (a) Entity C is required to prepare financial statements in accordance with PBE IPSAS 35 *Consolidated Financial Statements* and other information about its activities in accordance with the relevant accounting standard;¹⁴ and

¹³ Because the Charities Act 2005 refers to financial statements, that term has been used in this Appendix.

¹⁴ PBE IPSAS 35 is effective for annual periods beginning on or after 1 January 2019. Entities reporting for earlier periods should refer to PBE IPSAS 6 *Consolidated and Separate Financial Statements* (NFP).

- (b) Entities A, B and D are required to prepare their own financial statements that comply with the relevant accounting standard(s).

It is also appropriate for entities A, B, C and D to consider whether they have a relationship with any other entities for financial reporting purposes (see Explanatory Guide A9 *Financial Reporting by Not-for-profit Entities: Identifying Relationships for Financial Reporting Purposes* (EG A9)).

Scenario 2 – Registration as a Single Entity

NFP entities A, B, C and D are registered as a ‘single entity’ with Charities Services. One of those entities must be identified as the ‘parent’ entity for the purposes of the Charities Act 2005. In this case, Entity D has been identified as the ‘parent’.

Entity D is therefore responsible for filing the annual returns and the financial statements in respect of all of those entities.

Charities Services works with the parent entity to set reporting terms and conditions, in accordance with the Charities Act 2005. The reporting terms and conditions set out whether the financial statements of the ‘single entity’ are prepared on a consolidated basis or separately for each entity that forms part of the single entity. However the financial statements of the ‘single entity’ are prepared (that is, on a consolidated basis or separately for each entity), they shall comply with relevant accounting standard.

Scenario 2 – Variation 1

After considering the requirements of PBE IPSAS 35, the entities decide that Entity D controls entities A, B and C for financial reporting purposes. Charities Services sets reporting terms and conditions that require Entity D to prepare financial statements for the entities on a consolidated basis. In this case, all of the transactions and activities of entities A, B, C and D must be included in the consolidated financial statements, prepared as if entities A, B, C and D were a single entity. When preparing those financial statements, Entity D will need to determine whether any of the entities has a relationship with any of the other entities for financial reporting purposes (see EG A9), because this will impact on how the financial statements are prepared.

Scenario 2 – Variation 2

The entities determine that Entity C controls entities A, B and D for financial reporting purposes. Entity C is therefore the ‘parent’ (controlling entity) for financial reporting purposes. The transactions of entities A, B and D will be consolidated into Entity C when preparing the financial statements, using the procedures described in PBE IPSAS 35.

In circumstances such as this where the ‘parent’ for financial reporting purposes and the ‘parent’ under the Charities Act 2005 are different, Entity C and Entity D may want to discuss with Charities Services how the single entity and its members file their annual return and accompanying financial statements.

Scenario 2 – Variation 3

When entities A, B, C and D first registered as a single entity group (before the financial reporting standards came into force), the reporting terms and conditions set by Charities Services required separate financial statements to be prepared for each of entities A, B, C and D.

In this case, once the financial reporting standards came into force, each entity had to consider whether it had a relationship with any of the other entities for financial reporting purposes (see EG A9). For example, if Entity D concludes that it has control over entities A and B for financial reporting purposes, but does not have a relationship with Entity C for financial reporting purposes, then the transactions and activities of entities A and B must be included in the consolidated financial statements of Entity D, using the procedures described in PBE IPSAS 35. In addition, financial statements must be prepared and filed for each of entities A, B and C.

Entity D may want to discuss with Charities Services how entities A, B and D can file their annual return and accompanying financial statements. One option would be for the single entity group to consist of only entities A, B and D, with Entity D acting as the parent to file one annual return and one set of consolidated financial statements. In this example, Entity C would report and file separately.