



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

7 May 2019

Charities Act Team
Policy Group
Department of Internal Affairs
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WELLINGTON 6140

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Dear Sir/Madam

Department of Internal Affairs Discussion Document: *Modernising the Charities Act 2005*

Introduction

1. The External Reporting Board (XRB) is pleased to have the opportunity to comment on the Ministry's Discussion document: *Modernising the Charities Act 2005* (Discussion document). We have responded to selected questions from the Discussion document as our interest and mandate is limited to financial reporting.

XRB's role, responsibilities and focus

2. The XRB is an independent Crown Entity responsible for financial reporting strategy and the development and issue of accounting, and auditing and assurance, standards, in New Zealand.
3. Under the Financial Reporting Act 2013, the XRB issues accounting standards for all entities that are required, or opt, under law to prepare financial statements that comply with accounting standards issued by the XRB. From 1 April 2015, XRB accounting standards were required to be applied by all registered charities.
4. The law determines **who** is required to report, for example, registered charities. The XRB is responsible for **what** these entities are required to report, being XRB standards. Charities Services monitors and enforces compliance with XRB standards by registered charities.
5. In issuing its standards, the XRB focuses on users' needs for information in general purpose financial reports (GPFR), that is, information intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. For registered charities, these users are primarily grantors, donors (including members of the public) and service recipients.

6. Our submission is structured as follows:
 - (a) Summary of the XRB's main points; and
 - (b) Responses to selected questions from the Discussion document.
7. We have included, as an Appendix, background information on the development of XRB Simple Format Reporting Requirements.

Summary of the XRB's main points

8. The XRB is, in principle, opposed to the establishment of a new 'micro entity' tier for charities with less than \$10,000 operating expenditure and the suggestion that such entities should not be required to comply with current XRB accounting standards. Non-compliance on its own should not drive changes to the statutory reporting requirements.
9. These small charities are currently required to comply with the Tier 4 Simple Format Reporting Standard¹ as issued by the XRB. These reporting requirements have been specifically designed for smaller charitable entities and written in simple language for non-accountants (such as volunteers).
10. We consider that the current Tier 4 Simple Format Reporting requirements continue to provide appropriate reporting requirements for the approximately 39% of registered charities with annual expenditure less than \$10,000.
11. We note that Cabinet rules would require the Department of Internal Affairs to undertake a full regulatory impact analysis on any changes to the reporting requirements. If changes to the reporting requirements is the outcome of this review we request that the XRB be consulted further in relation to that process as the Crown body with statutory responsibilities in this area.
12. Both the XRB and Charities Services from 2012 have been consistent in their messaging that all registered charities regardless of size have some minimum statutory financial reporting obligations. This messaging reflects the Government view that all registered charities are accountable to the donating public and must report in a transparent manner to engender public trust and confidence in the charitable sector. Any change that provides an exemption from complying with XRB reporting standards for smaller entities will significantly weaken this message, leading to a likely decrease in the public's confidence across the entire charities sector.
13. The new reporting requirements for registered charities came into effect on 1 April 2015 following a review² of the quality of charities' annual reporting in 2009 by the then Ministry of Economic Development (MED)³. The primary basis for MBIE introducing new statutory reporting requirements was the view that all registered charities are accountable to the public

¹ *Tier 4: Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit) Standard.*

² The review identified problems with charities' financial statements, including concerns over inconsistent reporting formats, variety of accounting approaches, and the inadequate overall completeness and quality of information reported.

³ MED became part of the Ministry of Business, Innovation and Employment (MBIE) from 1 July 2012.

because they accept donations directly from the public and receive other types of preferential treatment, including income tax benefits (as noted on page 18 of the Discussion document). It was therefore considered important that all registered charities, regardless of size, have some form of statutory financial reporting requirements. We do not believe there have been any substantive changes in the charities sector that would require a reconsideration of this approach.

14. The Regulatory Impact Statement issued by MED in June 2011⁴ looked at financial reporting requirements for a wide range of entities and detailed this for registered charities:

We considered the option of exempting micro-entities from reporting but were convinced by the Charities Commission⁵ and others that simple format cash reporting is a very important element of micro charity accountability and that having a single format would reduce compliance costs.

15. The feedback we have received from charities to date has highlighted general support for the Tier 4 Simple Format Reporting Requirements developed by the XRB. We have been told that compliance with these requirements has promoted consistent reporting across the sector, which has enabled these entities to “tell their story” and has made it easier for them to apply for funding and solicit donations.
16. We note that compliance reviews conducted by Charities Services from 2017-2018 have shown an increasing number of Tier 4 registered charities are complying with the new Simple Format Reporting Requirements. To continue this trend of increased adoption of XRB accounting standards by smaller charities, ongoing awareness and educational support may be required.
17. While we would be pleased to receive feedback on any improvements we can make to the Tier 4 Simple Format Reporting Requirements or the associated guidance material to assist in promoting greater compliance by smaller charities we would not extend this to a removal or reduction of the very basic information currently required to be reported.⁶
18. The XRB values its engagement with its constituency and is always open to discussion with small charities, or their representative umbrella groups, to improve the understandability of the Tier 4 accounting requirements.

⁴ <https://treasury.govt.nz/publications/risa/regulatory-impact-statement-review-financial-reporting-framework>

⁵ Predecessor of Charities Services.

⁶ The XRB is conducting a Post-implementation Review of the Tier 3 and Tier 4 Simple Format Reporting Requirements over the 2019/2020 period.

Responses to specific questions in the Discussion document

19. We have provided response to specific questions related to financial reporting requirements under three sections of the Discussion document:
- (a) Obligations of Charities;
 - (b) Te Ao Māori; and
 - (c) Business.

Obligations of Charities – Reporting Requirements

Question: Is more support required for charities to meet their obligations? If so, what type of support is needed?

20. The requirements for Tier 3 and Tier 4 charities were developed with the non-accountant preparer in mind. To facilitate compliance, optional templates have been made available for Tier 3 and 4 charities on both XRB and Charities Services websites. The templates include detailed explanatory guidance written in non-technical language.
21. Despite extensive efforts by Charities Services and the XRB when the new requirements were introduced, we are aware that some registered charities are only now becoming aware of the new requirements.
22. We consider the 2018 Charities Services data that “only 58% of tier 4 charities successfully met the minimum reporting requirements”⁷ highlights that ongoing support is required from both the XRB and Charities Services, and other key stakeholders such as accounting professional bodies and philanthropic funders to assist in the continued improvement in smaller charities meeting their financial reporting obligations. This support could be in the form of education and awareness-raising activities in relation to Simple Format Reporting Requirements.
23. However, we are encouraged by the percentage increases in Table 1 which shows that Tier 4 had an increase from 37% compliance with these minimum financial reporting requirements in 2016 to 58% compliance in 2018.
24. We encourage the completion of further research and analysis by Charities Services to better understand the reasons for smaller charities not successfully meeting their minimum reporting requirements. Is non-compliance by certain smaller charities due to lack of awareness, simply avoidance, incomplete accounting records, or difficulties complying with specific reporting requirements? A better understanding of the reasons for non-compliance would assist in identifying appropriate courses of action.
25. The XRB is commencing a Post-implementation Review of the Accounting Standards Framework in 2019–2020. This will be followed by a standards-level review of the Accounting Standards of the Simple Format Reporting Requirements. This review will provide an opportunity for the XRB to consider making refinements to the Tier 4 Simple Format Reporting

⁷ Page 20 of the Discussion document.

Requirements and/or the associated guidance material to improve the understandability of the requirements.

Question: Should reporting requirements for small charities be reduced? If so, what would be the benefits? What would be the risks?

26. As noted earlier, the XRB is, in principle, opposed to the establishment of a new 'micro entity' tier for charities with less than \$10,000 operating expenditure and the suggestion that such entities should not be required to comply with current XRB reporting standards.
27. We consider that the current Tier 4 Simple Format Reporting Requirements continue to provide appropriate reporting requirements for the approximately 39% of registered charities with annual expenditure less than \$10,000. To maintain trust, confidence, accountability and transparency across the entire charities sector, we consider important that all charities, regardless of size, have some form of reporting requirements.
28. We support the promotion of financial literacy across all age groups as a complementary public policy objective to upskill all who may be required to comply with financial reporting requirements for their registered charity.
29. The XRB's view that reporting requirements for small charities should not be reduced, is supported by the reasons discussed below in paragraphs 30 to 32.
30. The new reporting requirements for registered charities require more time for full implementation by smaller charities.
 - (a) Given that the new reporting requirements have been in place for a relatively short time, we think it is important to consider the fact that the compliance statistics are still improving. Table 1 provides evidence of the improvement in financial reporting under the various tiers.⁸
 - (b) As noted earlier, the Tier 4 level of satisfactory reporting has increased by 21%, from 37% for the year ended 31 March 2016 to 58% for the year ended 31 March 2018.
 - (c) We also note that the Tier 3 level of satisfactory reporting has increased by 13% from 68% for the year ended 31 March 2016 to 81% for the year ended 31 March 2018. We would expect to continue to see some improvement in these figures as all registered charities become aware of, and used to preparation under, the new reporting requirements. Despite extensive efforts by Charities Services and the XRB when the new requirements were introduced, we are aware that some registered charities are only now becoming aware of the new requirements.

⁸ Figures for the year ended 31 March 2016 were sourced from a presentation by Charities Services to the New Zealand Accounting Standards Board on 4 May 2017. The figures for the year ended 31 March 2018 are from the Discussion document on page 20.

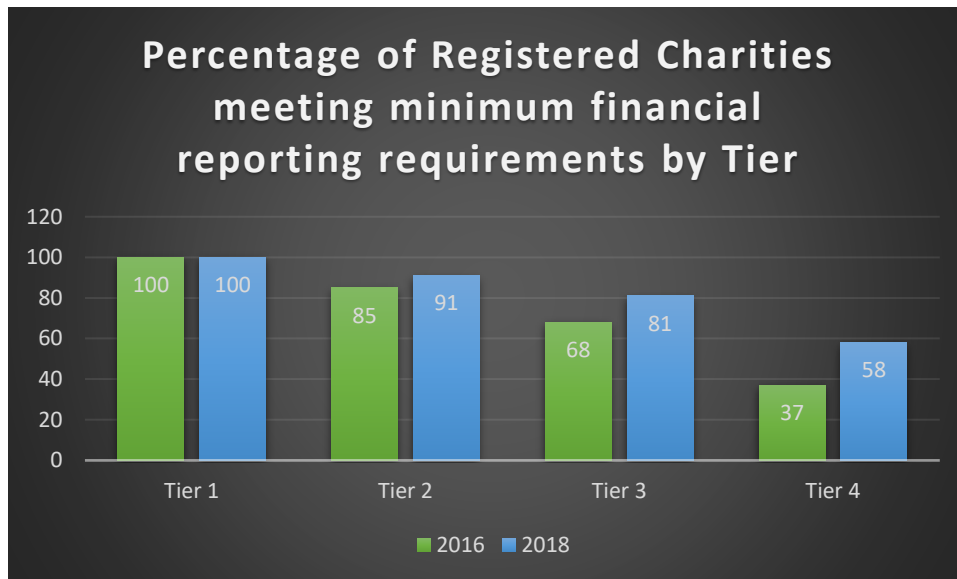


Table 1

- (d) As well as showing that some entities are not meeting the current requirements, the statistics also show that many registered charities, including many small charities, are meeting the requirements. There is a need for a deeper understanding of the characteristics of those entities that are meeting requirements versus those entities not meeting requirements. **Non-compliance on its own should not drive changes to the statutory reporting requirements.**
31. Any change to the current statutory reporting requirements for smaller charities will cause confusion across the sector and potentially undo the positive results achieved to date.
- (a) XRB research shows that 14,557 charities reported under Tier 4 for the year ended 31 March 2018. Tier 4 comprises 71% of the total charities which have reported, or 14,557 charities. 58% of the preparers of Tier 4 Performance reports have successfully met the minimum reporting requirements. These preparers may well have availed themselves of the opportunities available, such as resources on the Charities Services and XRB websites, and attendance at roadshows and webinars. Now that these preparers have succeeded in reporting in compliance with XRB standards, they will not wish to be disrupted by a further change in their reporting requirements. Many of these small charities are doing a good job and their Performance Reports are clear and easily understood. The widespread use of the templates has led to much more consistent reporting in the sector and made it easier for users to compare the Performance Reports of different charities.
- (b) Both the XRB and Charities Services from 2012 have been consistent in their messaging that all registered charities, regardless of size, have some minimum statutory financial reporting obligations. This messaging reflects the Government view that all registered charities are accountable to the donating public and must report in a transparent manner to engender public trust and confidence in the charitable sector. **Any change that provides an exemption from complying with XRB reporting standards for smaller**

entities will significantly weaken this message, leading to a likely decrease in the public’s confidence across the entire charities sector.

32. Many smaller charities currently eligible to report under Tier 4 Simple Format Reporting Requirements are opting-up to higher reporting requirements.

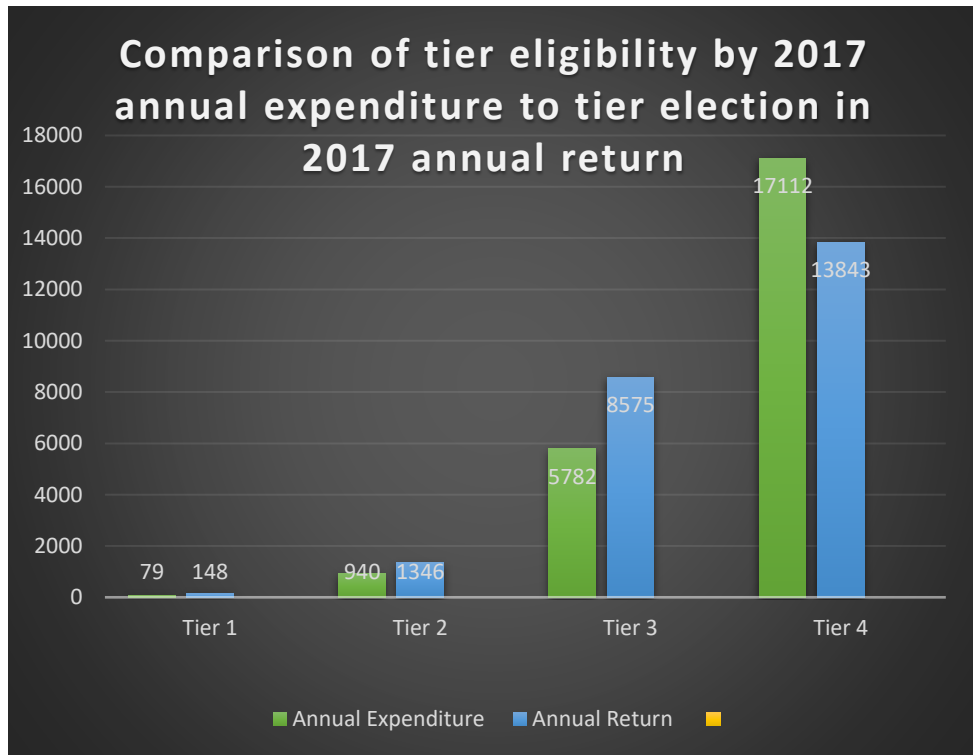


Table 2

- (a) Table 2 shows the absolute number of charities for 2017 across Tiers 2 to 4 were eligible to report in a Tier (green column), and the Tier which they elected to report under in their annual return (blue column). The difference between the two columns is the number which opted up to a higher reporting tier⁹.
- (b) For a percentage comparison, Table 3 shows the percentage of charities in each reporting tier based on annual expenditure in 2017.

⁹ No Tier 1 charities could opt up as they are already in the highest reporting tier.

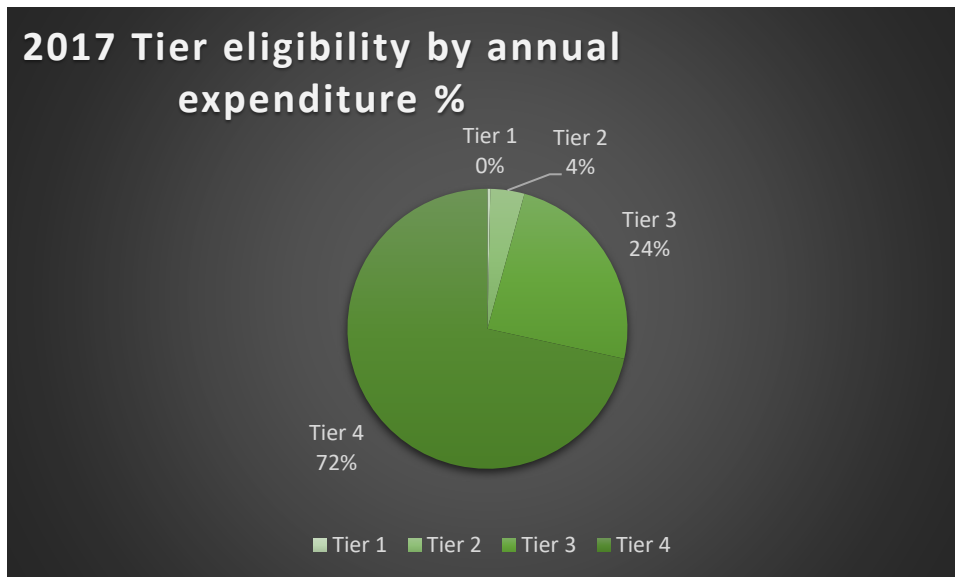


Table 3

- (c) Compare this to Table 4 which shows the percentage of charities in each reporting tier based on tier elected in their 2017 return.

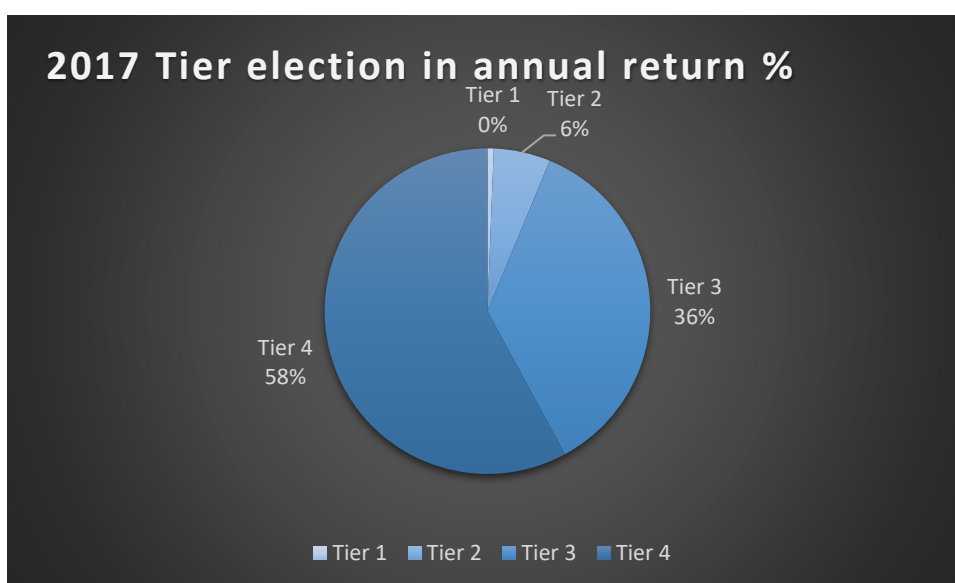


Table 4

- (d) The fact that 14% of, or 3,269, registered charities in the total annual returns submitted opted up from Tier 4 to a higher tier provides evidence that many small charities do not “struggle to meet reporting requirements”.¹⁰ Instead these charities in the sample have decided to use more complex reporting requirements by electing to report under a higher tier to better “tell the story” of their charity. Anecdotally, we understand from some auditors who act with many charities, that some small entities have opted up to Tier 3 accrual accounting have done so because they find the Tier 4 cash accounting too simplistic.

¹⁰ Heading on Page 20 of Discussion document.

33. Rather than reducing reporting requirements, a more appropriate response to the concern noted in the Discussion document is to understand more about the reasons **why** some registered charities are not meeting their reporting requirements, as noted in paragraph 24 above.
34. We also note that Form 4 Annual return form for a Tier 4 Charitable entity contains 15 pages of mandatory information requirements of which only 3 pages relate to financial information.
35. Should the reporting requirements be removed for Tier 4 charities the XRB questions where the figures to complete the annual return will be obtained from? There would be no consistent basis for the provision of minimum financial information required in the annual return. The XRB consulted widely and put substantial effort into developing simple format reporting requirements for Tier 3 and Tier 4.
36. The Tier 4 requirements are on a cash basis and we particularly note the following:
- (a) The Statement of Service Performance for Tier 4 requires charities to only report on their outputs and not their outcomes. We envisage simple performance measures such as the number of newsletters produced, or a list of events organised such as the annual fair and a raffle. Providing these measures does not require any knowledge of accounting.
 - (b) The Statement of Receipts and Payments is a cash account of what came into, and was paid out of, the charity's bank account.
 - (c) The Statement of Resources and Commitments is a **list** of money owed to and by the entity at balance date. We also ask for a list of other resources such as a computer or a motor vehicle. This is not a "balance sheet" but was developed with a view to having some information readily available should the entity be required to report under Tier 3 where accrual accounting is required.
 - (d) It is difficult to envisage how basic reporting could be made substantially simpler, albeit we would be very interested to learn of suggestions.

Te Ao Māori

Question: Are you aware of any particular problems with the reporting requirements for Māori charities?

37. No, the XRB are not aware of any particular problems with the reporting requirements for Māori charities.
38. However, the XRB sees this as a useful consultation question and will be interested in the feedback received. This feedback may assist in informing the XRB's Post-implementation Review of the Accounting Standards Framework currently timetabled for 2019/2020.

Business

Question: Should charities be required to report separately on business subsidiaries that they control that are not registered charities? If so, why?

39. The action following the responses to this question should be driven by the public demand for such information and the reasons given by respondents for wanting such information. For example, do users consider that such information would be useful to them in making decisions about donating to a charity?
40. We note that section 50 of the Charities Act 2005 gives Charities Services fairly broad powers to investigate a charitable entity. Before establishing new reporting requirements it would be helpful to confirm the extent to which section 50 of the Act would permit Charities Services to inquire into a business subsidiary of a registered charity which is not itself a registered charity. In particular, subsections 50(2)(a), (c) and (e) appear to be worded broadly enough to enable Charities Services to inquire into activities that generate inflows to, or outflows from, a registered charity or that expose the charity to business risks.
41. It would be useful to understand who is requesting further financial information on the activities of significant business subsidiaries that are controlled by registered charities. Is it the users of performance reports filed with Charities Services (e.g. donors, grantors and the broader public) or the sector regulator? This feedback will assist in determining whether any changes are needed to the statutory reporting obligations of registered charities and/or their subsidiaries, or to the requirements of particular accounting standards.

Closing comments

42. For the reasons explained earlier in our introductory comments, we have not commented on other questions in the Discussion document.
43. We would welcome the opportunity to meet with the Charities Act Policy Team to discuss these matters further. If you have any queries or require clarification of any matters in this submission, please contact Judith Pinny (Judith.pinny@xrb.govt.nz) or me.

Yours sincerely



Michele Embling
Chair
External Reporting Board

Appendix 1

Background information on the development of XRB Simple Format Reporting Requirements

1. The new reporting standards for registered charities came into effect on 1 April 2015 following a review of the quality of annual reporting by registered charities in 2009 by the MED. This review identified problems with the financial statements of registered charities, including concerns over inconsistent reporting formats, use of a variety of accounting approaches, and problems with the overall completeness and quality of information reported.

2. The Regulatory Impact Statement issued by MED in June 2011 looked at financial reporting requirements for a wide range of entities and detailed this for registered charities:

We considered the option of exempting micro-entities from reporting but were convinced by the Charities Commission and others that simple format cash reporting is a very important element of micro charity accountability and that having a single format would reduce compliance costs.

3. To address these issues, legislation was enacted requiring all registered charities to prepare annual financial statements in accordance with accounting standards issued by the XRB. The primary basis for introducing new statutory reporting requirements under amendments to the Charities Act 2005 in 2013 was the view that all registered charities are accountable to the public and must report in a transparent manner to engender public trust and confidence in the charitable sector. It was therefore considered important that all registered charities, regardless of size, have some form of standardised financial reporting requirements.

4. In response to these legislative changes, the XRB developed accounting standards for those not-for-profit PBEs who have a statutory requirement to prepare financial statements in accordance with accounting standards issued by the XRB, including registered charities. The tiers are generally based on the charity's annual expenditure over the previous two financial years. Larger charities in Tier 1 and Tier 2 are subject to more rigorous reporting requirements, consistent with international standards. If a charity has "public accountability" as defined in XRB A1¹¹ then it is automatically required to report under Tier 1.

5. The XRB developed the reporting framework for PBEs after extensive consultation with the not-for-profit sector and, in particular, with registered charities. A not-for-profit working group was formed and provided a report to the XRB in November 2011 entitled *Simple Format Reporting for NFP Entities*.¹² The working group focused on two main issues: what statements should be included in the simple format financial reports of NFP entities; and what specific items should be disclosed in those statements. Experienced preparers and users of financial reports from across the not-for-profit sector were members of this group. This report formed the basis for developing the Tier 3 and Tier 4 Simple Format Reporting Standards for Registered Charities.

¹¹ <https://www.xrb.govt.nz/accounting-standards/not-for-profit/xrb-a1/>, paragraphs 7-13.

¹² <https://www.xrb.govt.nz/dmsdocument/1822>

6. The XRB also commissioned research to identify the typical transactions in charities. This research assisted the XRB in developing standards for Tier 3 and Tier 4 registered charities that were fit for purpose. It was also used in considering whether any NFP modifications were needed to the standards that had been developed for Tier 1 and 2 public sector PBEs.¹³
7. A further report was commissioned by the XRB in 2012, this time focusing on *Reporting Entity Concepts for Tier 1 and Tier 2 NFP Entities*.¹⁴ Experienced leaders in charity reporting from across the not-for-profit sector were members of this group.
8. We have outlined the research that informed the development of standards for registered charities to show that the current standards were written from an evidence basis.
9. Once the standards had been developed, the XRB, together with Charities Services and other agencies completed four rounds of nationwide road shows to bring awareness of the new reporting standards to the registered charities and give attendees a chance to ask questions about the new standards. Response to the new standards was very positive. Attendees understood that transparency of their charity was necessary to engender confidence and trust in the charitable sector and to qualify for the tax exemption. The XRB and Charities Services also held webinars which were well attended.

¹³ <https://www.xrb.govt.nz/dmsdocument/1823>

¹⁴ <https://www.xrb.govt.nz/dmsdocument/1824>