Review of Accounting Standards
PBE SRF-A (NFP) and –C (NFP)

A submission by the accountants at Community Capacity Accounting

Contents

Summary

This is a submission by the accountants working at Community Capacity Accounting, who collectively have compiled or provided assurance on about 2,000 'Performance Reports' since the small NFP accounting standards came into effect in 2016 (we will refer to them simply as 'the standards' in this report for readability). Our mission is to help not-for-profits making sound financial decisions, and we have been working closely with the main funders in our region towards this. Meaningful and understandable annual financial reporting is an important part of that work.

The users of financial information compiled under the standards, and the people holding small not-for-profits accountable, are mostly non-accountants. It is fair to say that the introduction of the present accounting standards has made annual financial reports less useful to those readers, because the information they are looking for is less readily available, and presented very differently to what they are used to in small business. We argue that accountability and readability/ understandability are closely linked.

The recommendations in this submission aim to improve such readability, and therefore accountability and the organisation's ability to genuinely take ownership of their annual financial reports rather than this becoming a paper exercise only.

We are critical of non-financial reporting within an accounting standard, and we recommend to remove this, or make it optional. The key disadvantage of requiring this information in this place is that it distracts from very important financial information at a key moment in a not-for-profit's reporting cycle. While in favour of the idea of non-financial reporting by charities overall, we argue that the XRB is the wrong agency to regulate it, and that putting it in the hands of the charities regulator instead could make it more meaningful and prominent.

The financial reports of a not-for-profit, and therefore purpose-driven entity need to show how they have applied the funds they had available, and what their overall levels of reserves are. We recommend the removal of the minimum categories in financial activity statements (such as Cash Flow, Financial Performance and Receipts and Payments) as they in effect hide the items the stakeholders of a particular entity are likely to be interested in. The categorisation of transactions within these minimum categories is highly inconsistent, and using these aggregated figures for comparisons between organisations would be misleading. For financial position statements we recommend putting greater emphasis on an organisation's true wealth by using market values for buildings and investments, where these are easily obtainable, and replace the definition of 'control' with something more workable, so the influence of organisations that exist mainly or solely to support the reporting entity can be better shown. This is of great importance to philanthropic and local government funders, and therefore a matter of equity between charities of a similar nature.

Other recommendations include clarifying accounting practice with regards to grants, fixed assets, capital donations, consolidation, recognition and measurement of investments, reporting of cash-based activity and other matters, that better take into account the information needs of the users of these reports, and can be expected to improve consistency in reporting.

We hope that the XRB is able to do this review with humility, critical self-reflection, and an awareness perhaps of the particular bubble they operate in, and resulting high risk of tunnel vision. We also hope that the XRB is able to show restraint where their regulatory powers have the potential to impose significant cost on others and divert funds away from good purposes.

1. The Submitters

In the last year, Community Capacity Accounting has compiled or provided assurance on almost 600 sets of not-for-profit accounts, the majority of them registered charities. Since the new standards came into effect we have compiled or provided assurance on about 2,000 sets of 'Performance Reports' – probably more than any other accounting office anywhere in New Zealand. There are, at present, eight of us working here, and not-for-profits are our exclusive focus. We are a diverse bunch, with six nationalities represented and a variety of qualifications. Apart from accounting and business ones, staff also hold degrees in biological sciences, finance, IT and physics, some up to Masters level. This submission is from us, as accountants.

While accounting and assurance is our 'bread and butter' business, it is mostly a way for us to engage with an organisation on financial capacity building. We spend large amounts of our time advising, trouble-shooting, running seminars, providing individual tuition, problem-solving – and listening! In Christchurch we are considered the go-to people for anything to do with not-for-profit accounting. We work well with other accountants and auditors, and are privileged to enjoy tremendous goodwill from community organisations as well as funders and other agencies interested in the capacity of the sector.

We set out about 10 years ago to make not-for-profit accounts more meaningful and understandable, and accounting more accessible. Accountants and the users of not-for-profit financial reports do not speak the same language and see different things when looking at the same report. It is not uncommon for those working in financial administration of small not-for-profits to feel disempowered and talked down to by accountants. Bridging the gap between professional accounting and 'accuracy' as an accountant sees it, and how the non-accountant users of financial information in not-for-profits understand such information, is a constant struggle in our daily work as well.

The regulation of financial reporting for not-for-profits has not helped our mission. The 'Performance Report' is often not even recognised by users as the financial statements of their organisation, and it is not uncommon for charities to produce a different report for their own purposes, and even seek assurance on that one rather than the 'official' one. There is a perception that the 'Performance Report' is something that has to be done for legal reason, or because Charities Services require it, rather than something of any importance for themselves.

The difference between the XRB and Charities Services is known or understood by only a minority of charities, let alone the general public, and the lack of interest and awareness for regulation of charity financial reporting makes it problematic to introduce and maintain something that is so different to what people are used to seeing for their businesses or tax returns. If the standards weren't enforced by the charities regulator, they may well fall into disuse. Unless similar enforcement will be undertaken at the Companies Office when the standards become mandatory for all registered societies, we do not think they will be used widely.

While some organisations have genuinely very little interest in what we put in their annual financial statements, what format they're in, or anything else about them, for many others they are the only financial report a board or committee receives in a year, where any attempt at accuracy has been made. We have taken on two new clients in the last month, with annual expenditure of $400,000 and $1.1m respectively, where the boards have received no financial reports whatsoever through the year for many years now. This is not a particularly unusual story. We cannot emphasise enough how important it is that these annual financial statements are understandable and have meaning to the users.

The rest of this submission, therefore, is about our suggestions to adapt the standards in a way that make the financial reports better suited again for the main users. While much of it focuses on presentation (which is extremely important if you want financial information to be read by non-accountants), there are also other some changes in accounting that we propose where the present rules have proven to be either unworkable, or are being applied too inconsistently.

2. The Users

Readers of not-for-profit accounts are rarely outsiders. Their ‘investors’, funders or donors, engage directly with them, and where they don’t, the ‘Performance Report’ is not used prominently in their decision-making. People are not making decisions on the basis of these reports to work out a monetary return on their investment. They rarely, if ever, use them to determine which organisation is best suited to receive their donation, or could utilise it most efficiently. The case for extensive mandatory disclosures and detailed consistent accounting rules is, therefore, quite weak. The statements do, however, tell a story: where does the organisation put their money, and what are the funding streams and assets to do so? This story is important to stakeholders.

This means the main usefulness of the performance report is for those directly involved with the organisation, as well as funders – and almost all of them are non-accountants. Their interest in this particular report is in the financial sections. Non-financial information is available, and better reported, in other ways. The significant funders, such as DIA-Lotteries, Rata Foundation/Foundation North/Community Trusts, or City Councils engage with organisations, and find out about their non-financial activities through their local networks.

Where a financial report, that contains a lot of non-financial information, is tabled at an AGM or other meeting this has two effects:

- The likelihood of *any* of the information in it being read rapidly decreases with every added page. This is not helpful for financial accountability.
- People generally feel somewhat inadequate about their accounting knowledge, and they do not want to appear incompetent by asking a ‘dumb’ question. They are much more comfortable talking about what the organisation has done in the last year or so. This means a segment of the AGM or meeting, that is set aside to discuss financial matters, may turn into a discussion about the organisation’s activities instead, or a detail on the ‘entity information’ page, if this information is presented in the same report. This is also not helpful for financial accountability.

Because accountants have also not really shown much enthusiasm for the standards either, the application of them is vastly inconsistent beyond the use of a template. Rather than aiding those with limited accounting knowledge to prepare the ‘performance report’, the templates have had the effect of allowing many accountants to skip any deeper understanding of the standards, and to just make sure that all the boxes are filled in with *something.*

To make reporting consistent with the standards, and achieve the goals for their implementation, would require a large education effort. If there were 50 accountants at Charities Services tasked with this, they would still have a gruelling caseload of more than 500 organisations each. Of course, there are nowhere near that many accountants at Charities Services, and no resources anywhere else (other than the kind of philanthropic funding we access) for such work. Given the complete absence of public interest in this matter, we cannot see parliament or government ever having the appetite to provide the appropriate resources for this task.

We would also like to point out that, generally, a high compliance environment is detrimental to not-for-profit entrepreneurship and social enterprise.

3. Presentation of Report

Focus on 'Performance'

We note that the Tier 3 standard explicitly allows re-naming of statements and categories, and we make use of that. However, the language used in the Tier 3 and 4 standards as well as associated reporting templates, with the ubiquitous use of the word 'performance', is regrettable.

The word 'performance' is not value-neutral. It assumes judgment by the reader. Financial 'Performance' suggests that the important bit of information is meant to be whether a surplus has been generated, how high it is, and how well the organisation has done in reducing costs. Ironically, the reporting templates ask at least some of the right questions in the header: 'how was it funded' and 'what did it cost'?

More precisely, this statement is about 'how have we applied our funds' and 'where did the funds come from'? For this reason, we call it the Statement of Funding, in line with the idea that this is meant to tell a story, and to denote the important difference to the financial 'performance' of a business. Early versions of our internal templates (before the changes of 2016) put expenditure above income to support this narrative of seeking funding to apply to a purpose (rather than generating expenses in the pursuit of revenue).

Equally, the wording 'Service Performance' does not suggest a telling of a story. It suggests an answer to the question: did you provide enough bums on seats? The word 'performance' could simply be removed from the title of the statement, or it could be replaced by 'activity'.

The title of the report, 'Performance Report' suggests the opposite of telling a story: it suggests that the organisation is meant to be stripped bare here to the numbers only. At CCA we use the much more neutral term 'Financial and Service Statements' and do not pretend that it is anything more, or less, than a record of the financial activity and position of the organisation.

CCA accounts have a table on the cover page to link the statement titles to titles that are in more common use (or, in this case, are preferred by the regulator), which can help in introducing more not-for-profit-friendly language.

More detail on our efforts to better emphasise the difference between a not-for-profit and a business in accounting can be found here: https://commaccounting.co.nz/financial-reporting/not-for-profit-language/

We recommend the removal of the word 'performance' from report and statement titles.

We also note that the order of presenting the different statements is not prescribed, but that the reporting templates put the non-financial information before the financial.

Where XRB deems non-financial information necessary for inclusion in a report regulated through an accounting standard, **we believe accountability is better served by having the financial information at the beginning of the report, and minimise opportunities for distraction from the numbers**.

4. Statement of Service Performance

We do agree with the idea behind service reporting, but (a) this report is not the right place for it, and (b) XRB is not the right agency to regulate non-financial reporting of charities.

We also note that the inclusion of this type of non-financial reporting within a financial reporting standard is outside internationally accepted practice.

We therefore recommend to remove this Statement from the Tier 3 and 4 standards.

Our first argument is, again, about consistency. The information that organisations choose to put in this statement differs widely, and it does not allow comparison between organisations. The requirements of the standard are very broad and rather vague, and there is no good way to tie the disclosures in this statement to those in the financial parts. The requirement to provide the comparative figures for previous years is also routinely ignored – the organisation simply changes the reporting category if this is unfavourable.

Our second argument is about the usefulness of the content. We can see no value in the 'Outcomes' disclosure, as it is routinely misunderstood, as is the difference between outputs and outcomes in the first place.

When it comes to outputs, we generally see an attempt at marketing the organisation rather than genuine factual reporting. The outputs tables are cluttered with data such as web site hits or 'likes' on Facebook, pointless indicators such as number of Board members, or number of sponsors approached. Many numbers are unacceptable to auditors, such as the attendance at events, because no evidence can be provided – but only reporting that the event has happened greatly reduces the value of this disclosure. Again, a large education effort would be needed for this Statement to achieve its intended goal – informative videos on web sites will not be nearly enough.

The Statement of Service Performance also has high nuisance value for accountants, and along with any other accountants we have talked to about this matter, believe that ensuring compliant non-financial reporting, and the associated judgment calls, should not be an accountant's job at this level.

Instead, we suggest that non-financial reporting is handed back to the charities regulator. The idea behind it (telling a story beyond the financial) would be much better achieved by using an online form to be filled in annually by registered charities, which opens the possibility of making non-financial reporting more prominent on the register, and therefore more visible to the public than it is at present. Having the charities regulator in charge would also allow better involvement of researchers and others who have made not-for-profit evaluation their focus and are perhaps better qualified to do this than accountants. Evaluation is a much discussed topic in the social services sector especially, and the XRB is simply the wrong agency to have the power to describe the format and detail of such disclosures.

We note that the charities regulator at the moment does not give any prominence to this information, either. It remains hidden away in the Performance Report as an attachment under the label 'Financial Statements'. The annual return asks organisations to include a financial summary extracted from the statements, but makes no attempt at extracting any non-financial information.

As non-financial outcome or output tracking within an organisation is usually done by a different person to the one(s) looking after financial matters, it makes sense to separate these two types of reporting, which would by itself likely improve the quality of it as well (especially if combined with higher visibility).

Many organisations choose to produce an annual report, of which the 'Performance Report' is a part. Where this is done, the Statement of Service Performance duplicates the information, but, because it is a mandatory part of the 'Performance Report', cannot be omitted.

The next best alternative to removal of the Statement of Service Performance from the standard is to make it optional. There is not a strong enough case to make this a mandatory part of a financial reporting standard, with content determined by an agency outside of direct government control, and we believe the costs of inclusion to an organisation, accountants and auditors far outweigh the benefits.

Also note our general comments about the title of this statement and placement within the report above.

5. Statement of Financial Performance

Categorisation

At CCA we have always interpreted the explicit provision in the Tier 3 standard to disaggregate and rename the minimum categories as a general permission to those entities to choose their own categories as they make sense to their particular stakeholders, provided there are no categories that combine transactions from the minimum categories. This is consistent with NZ IFRS and NZ IPSAS, and we can see no good argument why this should be changed, or why Tier 3 and 4 entities should be more restricted here than Tier 1 or 2 entities.

As many of our clients use the XRB templates, and we generally use the minimum categories as headers in our own templates as well, we nevertheless think that these categories are largely impractical, because they have, in practice, not led to the desired consistency and comparability of reporting. They are probably the result of the development of a standardised reporting template for a large variety of entities, whose only commonality is that they are registered charities. It also appears that the charities regulator is particularly intent on these aggregated categories, but they are not an important user of these financial statements. If the charities regulator wanted aggregated figures for its own purposes, it can ask for these in the annual return (as they do), without this having to be a prescribed format of general purpose financial statements.

To the stakeholders of individual charities these categories are meaningless. If they were used to compare entities with each other, they would be misleading, as categorisation is so inconsistent. We believe this cannot be addressed with guidance notes, simply because most accountants, who only have a very small handful of non-profit clients, will not read them.

The following are some examples of inconsistent reporting with large effects on comparability:

Donation v Service-generated Income

The treatment of grants within the categories of ‘donations etc’ and ‘service provision’ varies between organisations, leading to very large differences – and therefore no comparability between organisations.

Our own interpretation of ‘use or return’ (and other) grants is that they belong in the ‘donations’ category. The funders we are closely working with also very strongly emphasise that their grants are a contribution to the organisation’s expenses, and in no way represent a purchase of outputs or outcomes, nor are they directly related to the total expenses incurred in the delivery of a particular service, and are entirely at the discretion of the funder.

However, a minority of the external auditors we work with, insist that some such grants are reported within the ‘service provision’ category. Some clients also put such grants there. While we understand their argument, we believe it is a misinterpretation of the nature of grants. If the categories are maintained, we believe that the standard should explicitly state that grants should be reported in the ‘donations’ category, to remove individual judgment calls and inconsistencies

Expenditure categories

Reporting within the minimum expenditure categories is very inconsistent, and some of the inconsistencies we see are:

- Staff/Volunteer expense section: sometimes includes contractor payments, sometimes doesn’t; we also frequently see the following items reported here: expenses incurred by staff and volunteers, including travel and accommodation or reimbursements; staff training; staff supervision; recruitment costs and others that inflate this category.

- 'Other' expenses vs 'Service'-related expenses: this is generally understood as meaning indirect vs direct costs, although the Tier 3 standard seems to indicate that 'other' expenses should be mostly extraordinary items not occurring regularly, and does state specifically that administrative expenses fall under 'service'-related. However administrative costs, travel costs, rent, office-related expenses such as subscriptions, marketing and promotion, accounting and audit or software subscriptions are all frequently reported in 'other expenses', although which ones of these are categorised where varies greatly. Incidentally, we do not understand why the Tier 3 standard prescribes depreciation to be listed under 'other' – the use of fixed assets is clearly an expense associated with the provision of services.
- Fundraising expenses: We believe the intention of this category is to make sure organisations disclose the cost of soliciting donations from the public separately, and we agree with this as a point of public accountability and direct interest to stakeholders. However, the standards are not very clear on this point. For example, we categorise the commissions charged by online donation facilities here as well as the fees paid to a professional grant writer, but most other accountants seem to classify these as expenses for service provision and, in the case of commissions, even allow netting out with donation income.

The classification of the same kind of expenditure within the minimum categories varies enough between organisations that comparability between organisations is not possible, and usage of minimum categories without disaggregation misleading.

The minimum categories also bar organisations from project-based financial reporting. Before the not-for-profit accounting standards put an end to it, CCA has been encouraging organisations to replace functional categories (wages, rent etc) with project-based ones. Forest & Bird (a Tier 2 entity) is a good example of an organisation managing to do this. We do not believe that tighter restrictions should be put on reporting in lower tiers if they don't exist in the higher ones.

We believe the main value of the statement of financial performance for charities lies in telling their story in financial terms. Or, to put it more bluntly: do they put their money where their mouth is? This cannot be achieved where a core functional category such as wages must be separated from other service-related categories. For those organisations who attempt project expense reporting, the Statement becomes clunky as payroll expenses always have to be separated out from the rest of the category. Project reporting is not possible at all in any way that would be remotely user-friendly when using the XRB-developed templates.

We also have privacy concerns around this. There are a large number of small groups with just one employee, where it is simply too easy to find out what a particular person earns with the present format of reporting.

We are not at all in favour of Statements that are cluttered with categories like 'Bank Fees', a separate interest category for each bank account, or similar. We agree that such detail can obscure the story that should be told. However, after the introduction of the NFP accounting standards this has simply been moved to the Notes, and the aggregated disclosures on the face of the statement are no less problematic. In most cases, such statements are indicative of poor bookkeeping capability within the organisation, which is a capacity issue, and cannot be resolved with accounting standards.

Given these issues, we recommend that minimum categories for the Statement of Financial Performance, Statement of Receipt and Payments, and Statement of Cash Flows are abolished, with the exception of mandatory separate disclosure of expenses relating to public fundraising, which is a figure of general public interest.

Revenue Recognition

A further issue with grants is the very arbitrary distinction of 'use-or-return' from other grants. We understand the reason for it, and do not disagree with the principle. However, the provision is impractical. Given the large number of philanthropic grants available, it is simply not practical for accountants or auditors to check in each individual case whether the organisation has signed an agreement that could potentially allow a funder to enforce return of the funds (let alone the probability that such enforcement would be executed).

Organisations (mostly) understand that grants usually come with obligations, and keep records of how such grants are spent. Even if there is no legal obligation to use or return funds, there is a moral one. Sometimes very substantial specific-purpose grants are made without a use-or-return provision, and this leads to a large distortion of an organisation's accrual-based financial activity statement if no liability is recognised.

We therefore recommend that the 'use-or-return' condition is modified to include all grants for which there is a clear expectation that they are to be used to cover specific expenditure, regardless of whether the donor asks for return.

Below-the-line items

The Tier 3 standard at the moment does not specifically allow any transactions to be recorded after the net surplus/deficit figure. **However, we believe that there are three situations where organisations should be allowed (but not required) to report transactions below the 'Net surplus' line**. Separating these transactions from ordinary operating income or expenses may provide more clarity to the reader in specific cases.

1.) Income from grants specifically for capital expenses. Such grants can have a vastly distorting impact on an organisation's ordinary operating income, especially if they concern a building, and lead to large paper surpluses that are widely misunderstood. Separating these from the other revenue categories and allowing them to be reported below the line would provide more clarity in such situations.
2.) 'Comprehensive' income from revaluations. This concerns either property revaluations, or unrealised gains or losses from investment portfolios. In the absence of 'comprehensive income', both these items would provide a distortion to an organisation's operational surplus or deficit.
3.) Income from investments. Some organisations have substantial investment returns which, when included in the total figures, somewhat blurs the understanding of how much the organisation depends on such passive income to fund its activities. Sometimes, organisations find it useful to report this separately, because they want to make it more obvious whether or not the organisation can make ends meet without such passive income. This should be allowed.

6. Financial Position

The main usefulness of this statement to not-for-profits stakeholders at all levels lies in providing a record of the organisation's 'wealth', especially with respect to assets not used for the provision of services. Funders use this information to determine whether the organisation is actually in need of their funds or should be asked to use their own assets first. Users often analyse the assets or net assets in relation to annual expenses to get a measure of what financial buffer they have to provide for future adversity.

We are not aware that any users perform business ration analytics, and do not believe that doing so would provide any useful information. This means that the structure of the position statement as well as certain disclosures need to be modified from its common business format to better accommodate the analyses that are commonly done in a not-for-profit context. It is especially important that assets not used in service provision are shown at realisable value, or at least a close proxy to it.

Valuation of Building and Land

We believe the reporting of buildings or land at cost (with or without depreciation) is meaningless in most cases, and misleads stakeholders about the financial position of the organisation. Where a GV of land or buildings is readily available, it should be used.

However, there is no need to mandate the use of accounting standard IPSAS 17 for this. This should be incorporated in both the Tier 3 and Tier 4 accounting standards directly, as it is a simple enough process.

We recommend to make the GV of land and buildings a mandatory disclosure in the Statement of Financial Position and the Statement of Resources and Commitments, without requiring organisations to use IPSAS 17

Tradeable Investments

Where an organisation invests in an investment portfolio, or publicly traded shares or other securities, the market value of such investments should be shown, as it is readily available. We believe it is not acceptable for organisations to state these at cost and at times substantially understate the value of such assets.

This also applies to investment properties. We believe the standard, template and guidance notes need to make it clearer that investment properties must be recorded in an investment category, and not as property, plant and equipment.

We recommend that disclosure of the market value of tradeable investments being made mandatory, at least in the Notes.

Intangible Assets

Both standards are silent on this, and it is not a common occurrence, but many organisations capitalise the cost of web sites and sometimes software.

We believe the ongoing measurement of a web site asset is too problematic to be meaningful, and the recognition of software expenses either as capital or operational too inconsistent in practice. **We recommend that both standards should say that intangible assets cannot be recognised on the Balance Sheet.**

Distinction between ‘current’ and ‘non-current’

We have discussed the usefulness of the distinction between current and non-current assets or liabilities in a not-for-profit context amongst ourselves, and are somewhat undecided.

The distinction can be misleading. We know that some funders use ‘working capital’, but they do so as a proxy indicator for an organisation’s financial stability and sustainability, rather than liquidity, as in a business situation. The figure they are actually interested in is the total amount of all assets that the organisation can liquefy without affecting service provision, less any significant liabilities, including commitments to funders. Where some of these assets or liabilities are broken up into ‘current’ and ‘non-current’, funders often get the wrong idea about the true wealth of an organisation. It is a matter of preference whether surplus funds are invested in cash deposits or by buying investment property, but the former are disadvantaged by this analytical process.

It is more important that assets are correctly classified as cash, investment, or PPE, and whether they *are able* to be liquefied within a reasonably short time, rather than whether they *are intended* to, which is what the current distinction between current and non-current is based on. This is perhaps a matter where we need to put aside traditional business-based accounting assumption in favour of usability, and requires some further discussion or thinking.

We recommend the distinction of current and non-current assets in the Tier 3 standard be reviewed, considering the actual usage of these disclosures in not-for-profit situations.

Capital Contributions

This line in the equity section of the reporting templates has no practical application and occasionally causes confusion. It is a rare occurrence for not-for-profits to have owners, they do not have any title to any part of the equity (other than what might be recognised as a liability), and no business analytics can be done on not-for-profits where this would be a useful figure. We recommend to remove this line and any reference to ‘owners’ in the standards.

Statement of Resources and Commitments

There is an overall problem with the brevity of the Tier 4 standard, as it is silent on so many matters, which is probably a result of wanting to encourage those with limited accounting knowledge. For our purposes, it would be desirable if some more detail would be given especially with respect to the Statement of Resources and Commitments.

Firstly, the title should probably be changed to ‘Statement of Assets and Liabilities’. Those terms are more widely understood in this context, and the standard itself mentions that they are equivalent.

The statement is a great alternative to a balance sheet, and puts compilation of a Tier 4 report at least within reach of a non-accountant. Some more clarification could be given on what should be put here, however.

We generally post accruals here (other than Accounts Payable or Receivable), if they are significant, such as interest, prepayments, Annual Leave entitlements, Income in Advance from government contracts and, of course, unexpended grants (which need to be moved to the Liabilities section, not other information). Only unexpended grants are a disclosure specifically mentioned in the standard.

You may have intended to only require reporting of impending cash payments or receipts here, but the other accruals are of interest to users of these Statements. For example, an organisation may have received substantial amounts of registration payments for an event in the next financial year, or may have made significant payments itself for such an event, such as a venue booking.

Occasionally, an organisation separates such prepayments out in the Statement of Receipts and Payments as well. Funders use the disclosures in the Statement of Resources & Commitments in the same way as in a Statement of Financial Position, which makes it important to avoid significant omissions.

We recommend to make it clearer that significant items relating to the next financial year should be reported as well as Accounts Payable and Receivable, if practicable to obtain. Where accurate figures are not readily available, but the impact of such items must be considered significant, their existence should be reported in the Notes.

When it comes to Accounts Payable and Receivable, it would also be useful for the Standard and the template guidance notes to clarify that this includes items dated after the end of the financial year, if they relate to purchases that occurred before.

Regarding Annual Leave entitlements, an argument could be made for both inclusion or exclusion, but it should be clear. We find it useful, as where this figure is not readily available, the organisation is obviously failing its obligations under the Holidays Act, and this disclosure might provide the impetus to tidy this up. However, we realise that this can't be a consideration for or against making this a mandatory disclosure.

Many organisations prefer to have a book value reported for fixed assets, rather than cost, especially since the charities regulator requires including this figure in a total assets figure on its Annual Return form, which is misleading. **We recommend to allow using depreciation as a method of valuation for fixed assets for Tier 4 entities**.

The standard could also benefit from better clarification of what it considers 'significant'. We understand that there are considerations other than the actual monetary value which may make an item 'significant', but it is still reasonable for clarity to provide a percentage figure as a guide.

7. Cash Flows and Receipts & Payments

As it stands, the Statement of Cash Flows in Tier 3 is not being used and therefore obsolete. This is despite the fact that users of not-for-profit financial statements do not understand accrual accounting very well, however the present format of the Statement of Cash Flows makes it too hard to understand for a non-accountant what exactly is reported here. We have also noticed that accountants at all levels struggle with compiling it, and when we are auditing new clients there are almost always substantial inaccuracies in it.

It is fundamentally equivalent to the Statement of Receipts and Payments, and more comparable to it than the Statement of Financial Performance. If comparability between organisations is a goal, aligning the format of the Statements of Cash Flows with that of the Statement of Receipts and Payments would be an obvious advantage, as it would allow comparisons between Tier 3 and 4 entities as well as just entities within the same tier. **We recommend to align the formats of the Statement of Cash Flows (Tier 3) with that of the Statement of Receipts and Payments (Tier 4).**

Cash-based information is important to not-for-profits, probably more so than accrual-based information. An accrual-based Statement of Financial Performance, for example, can distort an organisation’s performance in soliciting grants in the first place, as only grants that have been expended are reported as income. By the time a committee finds out that they have fallen woefully short of obtaining the required funds, it may be too late, if only accrual-based reporting is used. Furthermore, many organisations, ourselves included, can greatly control their reported accrual-based surpluses (and net assets) by controlling the timeframe over which they apply expenditure to generic operational grants, as this is a management decision that is fully compliant with accounting standards and the relevant funding agreements.

Cash-based statements also show the purchase of fixed assets, which is far more understandable to laypeople than depreciation, which many discard as not a ‘real’ expense. This generally makes this statement more ‘real’ and therefore credible (i.e. free of accounting trickery) to the readers than an accrual-based one.

Both statements could do with clarifying what should not be reported as operating transactions. We believe that reporting of movements in all funds held on behalf of other organisation or people are non-operating, including GST, bonds (i.e. deposits for venue hire, keys or similar), or funds of unrelated groups. Their balances are arbitrary and should not be allowed to distort operating cash flows. The wording of the categories in non-operating cash flow in Tier 4 also does not allow for loans given by the organisation to others – a more common occurrence than a not-for-profit taking a loan.

The definition of what constitutes cash omits credit or debit card balances, which should be included in cash flows. The inclusion of term deposits in the cash balance only, if they have maturities of 90 days or less, is completely arbitrary, and highly distortive of most readers’ understanding of an ‘investment’. Users of small NFP financial statements simply do not do the kind of business analytics that would make this distinction useful. Term deposits are cash that is almost instantly available if needed, regardless of maturity, and should always be reported in the cash balance.

8. Accounting Policies and Notes

The Notes are by far the least likely parts of the report to be read, but in not-for-profits especially they can be of great use in facilitating a reader's understanding of the financial information and the overall position of the entity.

Considering the users of small not-for-profit financials, we believe the usability of the Notes would benefit greatly from de-cluttering and de-jargoning to improve accountability.

Fixed Assets

The default Note regarding fixed assets fails to state whether there is a policy to expense asset purchases under a certain value, and also is not clear enough on whether the depreciation policy is based on the useful life of the asset, IRD tables, or some other measure of convenience. A ruling on whether IRD policies for Income Tax assessment are acceptable for the measurement of fixed assets of a Tier 3 entity would be desirable.

Going Concern

'Going concern' and 'Events after balance date' disclosures originated in the need of investors to be warned of events impacting on profit or profitability on a business, but are not relevant to most not for profits. Some do operate in a way that a reader could and should assume continuity based on past performance, but most do not. Many exist for the sole purpose of organising an annual or biannual event, with incomes or expenditures that can differ vastly between years due to location or other factors, and such organisations have no ongoing expenses. Others, such as conservation groups, may respond to a huge but very temporary increase of funding for the conservation need of the day, while having no costs whatsoever at times where there is no such activity. Those interested enough in a charity to pick up their accounts will know this. If they are complete strangers with only an academic interest, the disclosures in these notes are of not enough benefit to make them mandatory.

Related Party Transactions

We do not disagree at all with the intent behind this note, and our comments and recommendations are again based on practicality and experience. Related party transactions can significantly affect income and expenditure particularly, and by themselves are not 'good' or 'bad'. In practice, this provision is so poorly understood and inconsistently disclosed, and most accountants and auditors are so inexperienced in the nature and intent of these disclosures, that on balance we believe they do not meet their intended purpose.

Our clients, and quite possibly also many funding advisors, see a related party disclosure as something 'bad', and confuse them with a conflict of interest, or pecuniary benefit. New clients almost always answer 'no' to the question if there have been any such transactions, but in a large number of cases, perhaps even the majority, we find some, especially during audit. Almost all of these have an insignificant effect on the overall operation of the organisation, even though they may be significant in monetary value, or have to be disclosed for other reasons.

We have also noticed the regrettable practice of disclosing the names of those officers involved in a related party transaction, and therefore disclosing information in a public document that most would consider private or confidential from the individual's point of view. We always strongly discourage this, and know that it is not required, but it is another example of the negative effects a mandatory reporting provision can have, where it is widely misunderstood or misinterpreted.

We do not believe that there is a strong case for reporting related party transactions that are not significant. Under the current provisions, a committee member donating a second-hand stapler to the organisation represents a disclosable related party transaction. Free membership for committee members, or any donation from a committee member also come under this provision.

Views differed amongst ourselves whether the Related Party note should be mandatory at all, or whether the subject is sufficiently covered by A213 (Tier 3). This paragraph could include some guidance when disclosures such as Going Concern, Events After Balance Date or Related Party transactions should be made.

If related party disclosures remain a mandatory requirement, we believe some further examples of disclosable transactions are needed, especially cash donations from office holders, or transactions with a business fully or mainly owned by an office holder. It also needs to be made specific whether a paid manager is considered a related party (which would have the undesirable side effect of disclosing their salary).

9. Other Matters

Consolidation

We do not disagree with the intention behind making Tier 3 not-for-profits comply with IPSAS standards for consolidation if they control another entity; however, in practice the goal is not achieved.

We regularly strike cases where an entity should consolidate their accounts with another, but has not done so, usually out of ignorance for the rules (ignorance shared by most professional accountants as well).

Where an entity is familiar with those rules, but wants to avoid showing all its wealth, it can easily do so. Possible avenues for this are making sure the 'parent' entity reports under Tier 4 (or is not a registered charity at all); or structuring it in a way that the 'power' part of 'control' cannot be established with any certainty.

We would also argue that the reader is generally more interested in the financial activities of the 'parent' entity rather than the combined activity of al entities. To accommodate this need of the reader, we would recommend to have a 'parent entity' column added, if the requirement to consolidate remains.

The definition of 'control' is so technical, and so fraught with judgment, that even the charities regulator has been unable to update its web page with the latest changes to it for more than a year. It is unworkable. Where an auditor is convinced that control exists, but the entity disagrees, this becomes a matter of how thick-skinned that particular auditor is, especially when faced with a line-up of accountants and even lawyers with friends in high places.

Instead, the Tier 3 standard could simply be more explicit for the small number of situations where a single entity's financial performance or position alone does not paint an accurate enough picture:

- In cases where an entity is the sole or majority shareholder in a company, we believe the interests of the users are better served by not consolidating, but treating it as an investment. This is because the readers of the entity's financial statements are primarily interested in the financial activities of the parent organisation, and consolidating the company into it may obscure the 'story' that should be told.
- In cases where an entity's sole purpose of existence is to support or hold the assets of another, such as property trusts or 'friends of…' arrangements, we believe it should be mandatory to disclose the net surplus/deficit as well as the net assets of such entities within that of the benefitting entity, regardless of whether 'control' exists, provided this information is on public record (the supporting entities are almost always registered charities as well). This disclosure should be made at least prominently in the Notes.

We notice that some social service organisations, in particular faith-based ones, are successful in obscuring the wealth of the organisation(s) they are supported by to funders, and manage to secure funding for 'expenses' that represent internal transfers within the group, such as 'rent' or professional services. Some of us are referring to this as the 'Bermuda triangle', as money disappears from view in them as ships and planes did in the geographical one. The three corners of the triangle are the faith-based group, a property trust, and the social service organisation, and the money tends to be channelled towards an ever-increasing property portfolio. Sometimes the triangle gains more corners, where fully owned subsidiaries of a head church provide 'mortgages', or similar arrangements. We also believe that members of the local congregations are often deceived about what their donation or tithe is really paying for through such structures.

We cannot provide an easy answer to this problem, other than that we believe these connections should be disclosed, and the wealth that often exists in such structures be made more obvious. This may well be a matter for a separate standard, or even legislation.

Recognition and Measurement of Fixed Assets

The majority of fixed assets purchased by our clients are funded through grants (or occasionally specifically asked-for donations). In many cases, the asset is purchased for a specific service, that would simply not be provided without such a grant. This causes two problems when using standard accounting assumptions:

- Since the Statement of Financial Performance in a not-for-profit tells the story of how their expenses were funded, recognising a donation for an asset, the cost of which are capitalised, as income, falsifies that story, as it no longer matches income with expenditure. Such a grant or donation is in nature more similar to the capital contribution of the owner of a business, than to sales income.
- Where such assets are depreciated, this is again a misrepresentation of the organisation's cost of using this asset. If the asset was funded through a grant, and it can be expected to be replaced through another grant (or not replaced at all), there really is no cost to the organisation in using this asset other than maintenance, and therefore recognising a depreciation expense is misleading.

The tools of accounting were developed with businesses in mind, not not-for-profits, and these are the situations where they stop being useful. The matching principle of accounting appears to be in conflict with standard accounting practice here.

Earlier in this submission, we have suggested to at least allow such grants to be a below-the-line item in the Statement of Financial Performance. We also suggest such grants to be reported in the capital section of cash-based statements, rather than operational, to better comply with the matching principle.

Budget Reporting

To be of any use, budgets need to be living documents, which respond to the vagaries of funding and other issues occurring through the year. Which budget, then, is meant to be reported here?

We cannot see any useful information for the user in this, but the potential for confusion (it may be mistaken for actual numbers), and attempts to make the actual figures look better than they are by comparing them to a fictional budget.

They are also problematic in audit. They cannot be tested for the same assertions as actual figures, so an auditor can only look at whether they are misleading using ISA 720, but what if an entirely ludicrous budget could be shown to have been put to the Board and approved?

We recommend to remove any reference to budgets from the Tier 3 and 4 standards, and remove the budget columns from the template.

10. Summary of Recommendations

Presentation

1. Change default order of Statements, and put financial information first, to ensure readers of the report are not distracted from its main purpose.
2. Remove or replace the word ‘performance’ in Statement titles and use titles more appropriate to the not-for-profit nature or the entity.

Statement of Service Performance

3. Remove this statement from report altogether, and hand non-financial reporting back to the charities regulator (or the companies office for non-charities). The next best alternative is to make this a voluntary disclosure only.
4. If it remains, remove Outcome disclosure requirement, as it is too poorly understood and does not add value to the reader.
5. If it remains, impose a limit of disclosures to a single page for readability.

Statement of Financial Performance

6. Remove minimum categories, which do not provide useful information to users, and are applied too inconsistently to allow inter-entity comparisons. Keep a separate mandatory disclosure of public fundraising expenses, however.
7. Allow below-the-line recognition of the following types of transactions:
    a. Grants or donations given for capital expenses,
    b. Property and investment revaluations,
    c. (Realised) investment income.
8. Modify the ‘use-or-return’ condition to include all grants for which there is a clear expectation that they are to be used to cover specific expenditure, regardless of whether the donor asks for return.

Financial Position Statements

9. Make the use of GV for buildings and land mandatory, without requiring IPSAS 17, for both Tier 4 and 3. Allow revaluation gain or loss as a below-the-line item in Financial Performance, or allow as movement in an equity reserve only.
10. Review distinction between ‘current’ and ‘non-current’ assets with a view to better meet the information needs of users.
11. Mandate the use of market valuation for tradeable investments, where these are readily available, rather than recognition at cost.
12. Clarify that intangible assets must not be recognised under either standard.
13. Remove references to ‘owner’s capital’.
14. Clarify use of accruals other than Accounts Payable and Receivable under Tier 4.
15. Allow depreciation as a valuation method under Tier 4.

Statement of Cash Flows/ Receipts & Payments

16. Align the format of the Statement of Cash Flows (Tier 3) with that of the Statement of Receipts and Payments (Tier 4) to (a) make it more useful for Tier 3 entities and (b) allow better comparison between a Tier 3 and a Tier 4 entity.
17. Include all term deposits in the cash balance, regardless of maturity.
18. Clarify inclusion of credit or debit card balances in the cash balance.
19. Allow grants received for capital purchases to be listed in the non-operating section.

20. Clarify reporting for movement in funds held on behalf of others (or held by others on behalf of the organisation) - such as GST, bonds, unrelated organisations' funds - preferably as non-operating.
21. In templates, allow for others borrowing from the organisation, not just the organisation borrowing from others (non-operating movements).

Accounting Policies and Notes

22. Evaluate whether disclosures such as 'Basis of Reporting', 'Going Concern' or 'Events after Balance Date' provide enough usefulness for users of NFP financial statements that they should be mandatory.
23. Clarify that the Asset recognition note should contain a statement about asset capitalisation thresholds, if any, and the organisation's depreciation policy. Provide guidance whether the use of IRD rules for capitalisation and depreciation is, by default, acceptable.
24. Review Related Party disclosure rules to avoid insubstantial or inconsequential disclosures, and provide specific guidance on some more transactions.

Other Matters

25. Abolish the present requirement to consolidate entities, as the definition of 'control' is unworkable. Instead:
    a. Require recognition of majority-owned companies as investments, using their net assets in the balance sheet, and the movement in net assets as investment income in Financial Performance. For Tier 4 entities, require the disclosure of the Net Assets of such a company in 'Resources and Commitments'.
    b. Require disclosure of the net assets of a supporting entity, if publicly available.
    c. Consider how complex arrangements between related groups could be better regulated.
    d. If the requirement to consolidate remains, add a column showing the financial activities of the parent entity only.
26. The present recognition of grant-funded fixed assets is unsatisfactory, and should be reviewed.
27. Budget reporting is potentially distorting, and should not be encouraged.

Christchurch, 30 March 2021

Dennis Zhang	**Nick Hsu**
Eugenia Pokusai	**Othonia Konstantionopoulou**
Harald Breiding-Buss	**Rhys Pickett**
Jessica Jamieson	**Yvette Zeng**