



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

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This Explanatory Guide provides guidance for not-for-profit entities in determining the boundaries of the reporting entity that is required to prepare financial statements or a performance report in compliance with generally accepted accounting practice (GAAP) or a performance report in compliance with a non-GAAP Standard issued by the External Reporting Board or its sub-Board, the New Zealand Accounting Standards Board.

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Introduction

1. The objective of this Explanatory Guide is to help not-for-profit (NFP) entities that are required to prepare financial statements or a performance report that comply with generally accepted accounting practice (GAAP)¹ or a performance report that complies with a non-GAAP standard 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 statements or performance report, hereafter referred to as “financial statements”.
2. The financial statements of a reporting entity should reflect all the transactions, balances and activities of that entity to enable users of those financial statements to make appropriate decisions about resource allocation and to hold management of the entity to account.
3. GAAP comprises accounting standards issued by the External Reporting Board (XRB) or its sub-Board, the New Zealand Accounting Standards Board (NZASB) for NFP entities reporting in accordance with Tier 1, Tier 2 or Tier 3 PBE Accounting Standards. Non-GAAP standards for entities reporting in accordance with Tier 4 PBE Accounting Standards are also issued by the XRB or the NZASB.
4. There can be a tension between preparing financial statements that comply with GAAP or a non-GAAP standard (financial reporting) and the way in which entities 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. In circumstances where a reporting entity controls one or more other entities for financial reporting purposes, the controlling entity in that group is required to prepare consolidated financial statements in accordance with GAAP.
5. In light of this tension, entities may want to think about their reporting obligations and how best to register in order to minimise the compliance costs of preparing financial statements that comply with GAAP or a non-GAAP standard.
6. This Explanatory Guide is not a substitute for the relevant PBE Accounting Standards – its purpose is to help NFP entities in deciding what transactions, balances and activities need to be included in the financial statements of a reporting entity.

Objective of Financial Statements

7. The objective of financial statements is to provide information about the financial position, financial and service performance and cash flows of an entity that is useful to a wide range of users (for example, taxpayers, donors, lenders, suppliers, members and employees) in making and evaluating decisions about the allocation of resources and for the entity to demonstrate accountability for the resources entrusted to it.
8. For decision-making and accountability purposes the financial statements should provide:²
 - (a) Information about the sources, allocation and uses of financial resources;
 - (b) Information about how the entity financed its activities and met its cash requirements;
 - (c) Information that is useful in evaluating the entity’s ability to finance its activities and to meet its liabilities and commitments;
 - (d) Information about the financial condition of the entity and changes to that financial condition; and

¹ 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.

² See paragraph 15 of PBE IPSAS 1 *Presentation of Financial Statements*.

- (e) Aggregate information that is useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.
- 9. Although financial statements do not provide all the information that users may need to make decisions (since they largely portray the financial effects of past events), it is important that they include all the transactions, balances and activities of the reporting entity to enable users of those financial statements to make appropriate decisions. Incorrect or inappropriate decisions are likely to be made if some of the relevant information is not included in the reporting entity's financial statements.
- 10. Financial statements 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 statements 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 standard³.
- 12. For example, an entity that is registered as a charitable entity⁴ under the Charities Act 2005 is a reporting entity because charitable entities are required to prepare financial statements in accordance with GAAP (or a non-GAAP standard)⁵ and to file those financial statements with the Department of Internal Affairs, Charities Services. As mentioned above, this requirement to prepare financial statements in accordance with GAAP or a non-GAAP standard may be in tension with the way in which an entity registers under the Charities Act 2005 and, therefore, lead to a reconsideration of the way an entity is registered.

Registration Under the Charities Act 2005

- 13. One of the tensions between financial reporting and the way in which an entity registers under the Charities Act 2005 is the use of the term 'parent'.
- 14. The Charities Act 2005 permits entities that are affiliated or closely related to register as a 'single entity'⁶ and Charities Services decides how those entities are to report⁷. For the purposes of the Charities Act 2005, the entity that requests the registration and treatment of several entities as a single entity is described as the 'parent' entity. This is the entity that Charities Services deals with for the purposes of the Charities Act 2005.
- 15. The term 'parent' entity in the Charities Act 2005 is not necessarily the same as a 'parent' entity (or 'controlling entity' as it is referred to in PBE Accounting Standards⁸) for the purpose of preparing financial statements in accordance with GAAP. A 'parent' or 'controlling entity' for financial reporting purposes is an entity which has one or more controlled entities⁹ (see EG A9 for guidance on determining whether an entity has a control relationship with another entity for financial reporting purposes). Appendix A of PBE IPSAS 6 *Consolidated and Separate Financial Statements* (Not-for-profit) (PBE IPSAS 6 (NFP)) provides guidance for NFP entities when assessing whether an entity controls another entity for financial reporting purposes. PBE IPSAS 6 (NFP) also outlines the procedures needed to prepare consolidated financial statements.
- 16. Where an entity controls one or more entities (whether registered charities or otherwise) for financial reporting purposes this is referred to as a 'group'¹⁰ or an 'economic entity'¹¹. Under GAAP, the entity that controls one or more entities is required to prepare consolidated financial statements (also known as group financial statements) as if all the entities in the group or economic entity were one entity.

³ Section 5 of the Financial Reporting Act 2013

⁴ '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'.

⁵ Section 42A of the Charities Act 2005

⁶ Section 44 of the Charities Act 2005

⁷ Section 46(1A) of the Charities Act 2005

⁸ Paragraph 7 of PBE IPSAS 6 *Consolidated and Separate Financial Statements* (Not-for-profit)

⁹ Paragraph 7 of PBE IPSAS 6 *Consolidated and Separate Financial Statements* (Not-for-profit)

¹⁰ In the For-profit Accounting Standards

¹¹ In the PBE Accounting Standards

17. A reporting entity may also want to consider whether it is controlled by another entity for financial reporting purposes. Where this is the case, it may be appropriate for the entity to look at how it is registered with Charities Services and whether that registration is suited to the purpose and operation of the entity and the entity that controls it (taking into account the compliance costs of preparing GAAP-compliant financial statements).

Identifying the Reporting Entity

18. For financial reporting purposes, a reporting entity can be a single entity or several entities that are an economic entity (group) and therefore required to prepare a set of financial statements as if they were one entity.
19. Although this guidance applies to identifying the boundary of single reporting entities and group reporting entities, it can sometimes be helpful to firstly establish the boundary of the single entity and secondly, establish if the single entity controls other entities or is itself controlled by another entity for financial reporting purposes.
20. The reporting entity is relatively simple to identify if it has legal status, such as 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.
21. However, where an NFP entity is unincorporated, that is, it has no legal status¹² (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 statements. Conversely, branches affiliated to, but not part of, an NFP entity may be constituted and registered as separate reporting entities. This means that each branch would include only transactions undertaken by it, or on its behalf, in its own financial statements.
22. Appendix A contains illustrative examples of determining the transactions, balances and activities to be included in the financial statements 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 Statements of a Reporting Entity?

23. The financial statements of a reporting entity should include all of the transactions, balances and activities of the reporting entity based on the definitions of assets, liabilities, equity, revenue and expenses in the Public Benefit Entities' *Framework* (PBE *Framework*) (see paragraphs 49–80 for definitions of, and guidance about, assets, liabilities, equity, revenue and expenses).

Branches and Similar Networks

24. 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 statements of the reporting entity. This does not prevent the branch from preparing financial statements or reports about its activities to meet the information needs of its stakeholders. Those financial statements or reports may be prepared by the branch using accounting standards issued by the XRB or NZASB or they may be prepared solely to meet the specific information needs of stakeholders of that branch in a form that is appropriate for those stakeholders.
25. Where a branch of an NFP organisation is established as a separate legal entity, GAAP requires the NFP organisation to consider its relationship, if any, with that branch for financial reporting purposes and account for that relationship accordingly (see EG A9 for further guidance on the nature of relationships for financial reporting purposes). 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 reports about its activities to meet the information needs of its stakeholders even if it does not have statutory reporting obligations.
26. 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

¹² 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.

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 statements of the national organisation;
 - (b) A separate legal entity 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;
 - (c) A separate legal entity with no relationship with the national organisation for financial reporting purposes, in which case the NFP organisations will be required to prepare their own GAAP-compliant financial statements if they are registered under the Charities Act 2005.
27. In some cases, NFP organisations are established as separate legal entities. However, they are unable to change their constitutions or founding documents without the approval of the national organisation. In such cases, the national organisation may have a relationship with those NFP organisations for financial reporting purposes (see EG A9 for further guidance on the nature of relationships for financial reporting purposes).
28. As noted in paragraph 26(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.

Umbrella Organisations

29. Some entities are described as ‘umbrella’ organisations, which may have organisations or individuals as members. 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.

What should be Included in the Financial Statements of a Reporting Entity?

30. If it is unclear what is to be included in the financial statements 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.

Financial Reporting in Accordance with GAAP or a Non-GAAP Standard

31. Applicable financial reporting standards (GAAP or a non-GAAP standard) contain the recognition, measurement, presentation and disclosure requirements for the items to be included in the financial statements.
32. 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 statements and section 42A requires those financial statements to

- comply with GAAP (for a specified NFP entity¹³) or a non-GAAP standard (for entities other than a specified NFP entity).
33. 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 entity¹⁴, or (ii) separately in respect of each entity that forms part of the single entity¹⁵. Charities Services determines the manner in which those financial statements are to be prepared¹⁶, but the financial statements must still comply with GAAP or a non-GAAP standard.
 34. A charitable entity may want to register in the manner that reflects its financial reporting requirements under GAAP or a non-GAAP standard in order to reduce complexity and compliance costs. This involves identifying any relationships that the entity has with other entities for financial reporting purposes, looking at both (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.
 35. Appendix A provides examples of the financial reporting requirements for registered charities in different circumstances.

¹³ A specified not-for-profit entity is an entity in respect of an accounting period if, in each of the 2 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).

¹⁴ 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.

¹⁵ Section 46(1A) of the Charities Act 2005

¹⁶ Section 46(1B) of the Charities Act 2005

Appendix A

Illustrative Examples of Determining the Activities, Transactions and Balances to be Included in the Financial Statements of the Reporting Entity

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.

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.

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 situations are outlined below.

Separate Registration

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

In this situation:

- (a) Entity C is required to prepare consolidated financial statements in accordance with PBE IPSAS 6 *Consolidated and Separate Financial Statements* (Not-for-profit) (PBE IPSAS 6 (NFP)); and
- (b) Entities A, B and D are required to prepare their own financial statements that comply with the relevant GAAP.

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)).

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 decides 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 are required to comply with GAAP or a non-GAAP standard.

Example 1

Charities Services decides that Entity D must 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 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. In particular, even though Entity D is identified as the 'parent' entity for the purposes of the Charities Act 2005, it might not be a 'parent' (controlling entity) for financial reporting purposes.

For example, if Entity C controls entities A, B and D for financial reporting purposes, then Entity C will be the 'parent' (controlling entity) for financial reporting purposes. In this case, 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 6 (NFP). Entity D, as the 'parent' under the Charities Act 2005, files those consolidated financial statements with Charities Services.

In circumstances such as this, Entity D may want to discuss with Charities Services how the single entity and its members can file their annual return and accompanying financial statements.

Example 2

Charities Services decides that separate financial statements must be prepared for each of entities A, B, C and D. In this case, when the financial statements for each entity are prepared, each entity must consider whether it has 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 financial statements of Entity D, using the procedures described in PBE IPSAS 6 (NFP). 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.